HOW CAN I FINANCE MY ENTERTAINMENT PROJECT?

Without a doubt, obtaining the financing for your project will be the greatest obstacle you will probably face in developing your leisure project. Finding financing takes tenacity. You will need optimism, determination and the patience to encounter dozens or more turndowns and hurtles before you will find financing.

There are a number of reasons why it is so difficult to obtain financing:

- You will be considered a start-up business. Start-up businesses, by their very nature, are difficult to finance as the owners rarely have track records in the industry.
- The family entertainment center and related location-based leisure industry is still considered quite young. Banks and investors cannot turn to any long-term statistical studies of success/failure rates to assess their risks. The failures of some national chains like Discovery Zone scare banks who tend to focus on the negative, rather than the positive, or they aren't willing to understand why DZ's failure is not an industry wide malady.
- If the business fails, any equipment collateral on a business loan will have minimal value.

Following are a few suggestions of where you might look for your project's financing.

A few loan programs in the U.S. can partially fund a project.

a) SBA 7a – You have probably heard about this conventional SBA loan program. This loan program requires personal guarantees and possibly additional collateral such as a 2nd mortgage on your home.
b) SBA 504 – This type SBA loan guarantee is issued by the local development authority in your city or county in cooperation with a band. The loan can be for up to $1,500,000 for as much as 40% of total project cost and subordinated to a bank loan equal to up to 50% of cost. The interest rate is fixed over the term of the loan and the term of the loan can be for as long as 20 years. One new job must be created for every $65,000 of the 504-loan amount. Personal guarantees are usually required. For more detailed information on SBA loan programs, check out the SBA's web site: http://www.sba.gov/financing/
c) The United States Department of Agriculture has some loan guarantee programs for rural communities. If you project is not in a large city, it is worth checking this out, as some suburban communities qualify under the USDA Rural Development programs. Check it out at: http://www.rurdev.usda.gov/
d) Mortgage financing – If your project will include ownership of the real estate, then you should be able to obtain partial financing based upon the value of the real estate. The percentage of this value you can borrow will be dependent upon what the real estate and building (not including equipment and special finishes) appraises for based upon its alternate use should the business fail and what the lender's loan policies are. Even best case, don't expect to be able to borrow more than about 70% of the real estate's value.

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e) Collateral Loans – most banks will loan up to about 90% of the amount of liquid assets (CD's, bonds, etc.) that you pledge as collateral.
f) Leases – It is possible to lease equipment that is considered movable and could be sold for use in another facility.

Most of our clients and industry startups turn to investors or partners for the majority of their financing.

Many people are initially adverse to the idea of taking in partners. They worry that they will not have control of the business. Most investors are not interested in being involved in the day-to-day management of the business. They are interested in finding mostly passive investments, which will generate an annual return and possible appreciation of the original capital.

You don't have to own more than 50% of the business to have management control. Your business can be structured as a Limited Liability Corporation (LLC), a limited partnership or other legal entity that grants you management authority on all but major decisions such as borrowing, major capital expenditures and selling the business.

Having partners rather than loans can be to your financial advantage. Your risk is greatly reduced or eliminated. You are not guaranteeing loans. It is no longer a question of "Can you make the loan payments?" but rather, "How much cash is left over at the end of the year that can be distributed to the project's partners?" This greatly reduces both the project's and your risk. If you work out the math on most partnerships, the developer-partner's share of the profits/cash flow is usually greater than if they had used loans instead. Most investors are successful business people, so they are a great resource to draw on for advice with the business. Moreover, it is far better to own a percentage of a business that gets open rather than 100% of a business that never opens.

Most investors will want you to have some investment in the business. This gives them psychological comfort that you will not walk away if things get tough. If you are managing the business, you are entitled to a management fee for your time in addition to your share of ownership, profits and cash flow.

We are often asked what type of returns a leisure project will generate. As a broad rule of thumb, if the project does not generate an EBITDA of somewhere between 15% and 25%, we recommend that clients do not proceed. The actual potential return on invested capital is a function of many variables, including how much of the cost is borrowed and the annual debt service. When the debt service constant is lower than the project's cash-on-cash return, it leverages the return for the invested capital. If your project includes ownership of the real estate, returns will be less. The reason is that real estate returns are lower than entertainment business returns, so the real estate portion of the investment dilutes the overall rate of return. To put it another way, the market rental value of the real estate will not generate a high return on the real estate investment. Financing for the real estate portion of the investment is more available, however the overall return on the invested capital in the entire project will still be lower. This makes

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financing projects that own the real estate more difficult, as investors will still tend to look at the total investment as being in the business operation, and expect a high return.

This problem can often be addressed by breaking the project into two different companies, one that owns the real estate and leases it to the operating company, and the other that owns and operates the business. Different investors are then obtained for each company. Investors in the real estate company do not expect high returns, as real estate is considered to have less risk. The return to the investors in the operating company is not diluted, so you can attract investors for that more risky company as it will have higher returns.

It is always better to lease the real estate if possible. This simplifies raising money for the project, as the returns are higher and less money is needed.

We recommend that you approach the least likely investor or lender prospects initially. This will give you a chance to learn the type of tough questions investors ask, be able to rehearse your answers for later investors, and revise your business plan to address their criticisms. Consider it a *beta test* of your business plan. You'll be up the learning curve and increase your odds of success with the more probable investors and lenders.

Your greatest personal risk will be at the beginning stage of developing the project, before you have secured loans or investors. To secure either, you will probably need:

- a site for the project
- a market feasibility study
- a preliminary plan (and perhaps renderings)
- detailed cost estimate
- attendance and per capita expenditure projections
- pro forma projections of revenues, expenses, EBITDA, cash flow and after tax profits
- details on how the project will be marketed and managed
- information on your background and experience.

These are all incorporated into what is called the *Business Plan*. There are a number of good books available on how to write a business plan.

Depending on the state you are located in and how you structure the business to bring in investors, you may also need some form of investment prospectus. You should consult an attorney or investigate the applicable security laws to determine this requirement.

To prepare and pay for the business plan, attorney's fees and other initial expenses, you will need $50,000 or more in front-end capital before you will be in a position to seriously approach lenders or investors.

Some owners are not in a position to invest this much front-end capital on their own. In that case, one option is to find an initial investor who believes in you and your project and is willing to invest at an early project stage in return for a greater ownership percentage per dollar invested than later investors. A good prospect for this initial

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investor is someone who lives in your community, has interest in bettering the community and sees your project as bringing it a valuable amenity.

Where do you find investors? They're everywhere. The problem is to locate them. This is where perseverance comes into play. You probably know some potential prospects, or at the least some people who could steer you to good prospects. Try your lawyer, accountant, stockbroker, investment advisor, insurance agent, doctors, etc. Often, it works better to approach them indirectly by saying you have this investment opportunity and you were wondering if they know of any potential investors they could recommend.

The first investor is the toughest to get. No one ever wants to be first. If your first investor is someone well known and respected in the business community, this will increase your prospects for attracting additional investors.

Here's a real story from our experience of how the seemingly impossible is often accomplished. In the early 1990's we were called by a woman about development of a children's entertainment center. We visited her to evaluate a potential site and the market. After we sent her a bill for our work, she called to say she didn't have enough money to pay it in full and could we take installments. Reluctantly we agreed (and have since changed our policy to be paid in advance by new clients.) The more important part is that during the visit, she asked us how she could find investors. We advised her to approach the wealthiest or most successful business people in her town. About one month later, she called back to say the 3rd person she contacted, the owner of the McDonald's restaurants in town, wanted to be her partner. He was interested in opening a children's entertainment center, but didn't have the time to devote to its management. They formed a partnership, she received a percentage of the business for no investment and a management fee and the center was built and opened. Not all investors are found that easily, but it can be done.

The White Hutchinson Leisure & Learning Group cannot marry you to particular investors or lenders, but we can help you select a good site and based upon market research, develop the formula for a successful business including a market study, plans and realistic projections and cost estimates, which should help you find the financing you need.

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