

Financing Fundamentals

Feasibility studies, appraisal reports, industry knowledge—all are necessary to obtain financing for a new waterpark project in 2020 and beyond.

Among the many challenges facing the waterpark industry in 2020, one of the biggest questions on the minds of many developers is: after so many years of growth in the industry, are new waterpark projects still being financed? Financing a new construction waterpark has always been extremely difficult, but 2020 has the added complication of an unprecedented lack of confidence in a market that has been ravaged by the COVID-19 pandemic and subsequent unexpected closure of so many leisure properties.

As a result, lenders have pulled back on financing all types of new construction projects in the spring 2020.

When capital starts to flow again, what will characterize the deal, the deal makers and the development project itself? We have reviewed the types of financing that were generally available pre-COVID-19 and the characteristics of the developer, the lender and the typical waterpark development. Understanding the challenges of obtaining financing is the key to determine how to overcome potential obstacles.

Financing Waterparks

Waterparks have been financed through a variety of methods including the following:

- Traditional banks
- Government backed bonds, loans and grants
- Investment bankers specializing in the hospitality industry
- Self-financed through cash flow of other properties or by wealthy individuals.

Our interviews with various lenders and developers reveal that high levels of persistence, innovation, capital and creativity are required for pulling together project financing from a variety of sources.

We interviewed various lenders and investors concerning the financing of waterparks at the end of 2019 and in 2020. With the current COVID-19 pandemic affecting new financing of all types, hospitality and leisure managers across the globe are re-thinking the design of hotels and waterparks to

accommodate future travelers who are leery of congregating in large groups due to the risk of contracting an illness.

Before the pandemic, some lenders were excited to review potential waterpark projects. In February, one of our interviewees called to discuss any new projects in our feasibility study pipeline because they had “money to turn waterpark dreams into reality.” Just two months later, we are seeing investors and lenders holding back, waiting to see how long the pandemic’s effects on our economy will last and which projects might still be appropriate for a post-pandemic future.

As an example, the City of Bloomington planned to issue

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bonds in March 2020 to finance a \$250 million, more than 250,000-square-foot indoor waterpark at the Mall of America, which would be one of the largest in the country and similar to the soon-to-be opened DreamWorks indoor waterpark at American Dream. With the COVID-19 pandemic causing the Mall of America to close and leaving the tourism market reeling, those bonds still have not been issued. The City of Bloomington had planned to issue bonds through the Arizona Industrial Development Authority and have an affiliate of the nonprofit Provident Resource Group own the waterpark.

In order to determine what the future might hold for hospitality and leisure projects, we reviewed recently financed projects to get an idea of what the market looked like before the COVID-19 pandemic. The following chart shows the top hotel and waterpark lenders from 2019.

TOP HOTEL & WATERPARK LENDERS 2019	
Hotel Lenders	Waterpark Lenders
JP Morgan Chase Bank	Wells Fargo Bank
Goldman Sachs Bank USA	JP Morgan Chase Bank
Wells Fargo Bank	Bank of America
Bank of America	Seminole Mortgage Trust
ACORE Capital Mortgage	American Riviera Bank

Source: Hotel & Leisure Advisors

The following table summarizes the rates and types of financing commonly used with waterparks for a borrower who is creditworthy and has strong liquidity.

WATERPARK FINANCING SURVEY 2020		
	Construction Financing	Permanent Financing
Interest Rate (%)	4.5% - 9.5%	4.0% - 9.0%
Terms of Loan (Years)	1 - 4 years	5 - 10 years
Years Amortize	Interest only	20 to 30 years
Debt Coverage Ratio	1.3 - 2	1.15 - 2+
Loan to Value (%)	55% - 80%	40% - 80%

Source: Hotel & Leisure Advisors

Looking for a lender with prior knowledge of the waterpark or hospitality industries could help a developer obtain financing for a new project.

The rates quoted for the 2020 survey indicate that lenders expect interest rates above other commercial asset classes, like apartments. According to our survey, loan-to-value ratios remained lower for government-backed loans, although some lenders were willing to consider the 70 percent to 80 percent of market value range before COVID-19. Construction loan terms had increased, as the scale of new projects is extending construction timelines. Many lenders were offering construction-to-permanent loans that automatically adjust when a project is completed.

Most lenders are now saying that new lending is frozen as of spring 2020 for new construction hospitality projects. Until new rating guidance is available for underwriting projects that have suffered a one-time revenue loss from COVID-19, they will be unable to finance hotel or attraction projects without bonding and other government guarantees.

Developer Characteristics

Lenders and investors look for savvy developers who understand their markets, have experience in their development field and are well-capitalized. The following describes some of these major characteristics that lenders and investors consider.

DEVELOPER EXPERTISE

- Having prior development experience with success is fundamental to a lender. Be prepared to support claims of prior projects coming to fruition on time and within budget. The development of a strong business plan illustrates the developer's expertise and commitment to success.

MANAGEMENT EXPERTISE

- Lenders are looking for owners who are engaged in the

knowledge of operations and who know the intricacies of waterpark operations. In the case of an indoor waterpark resort, they also want a management company with experience in hotel operations. Developers will need to demonstrate this expertise to lenders who may not be familiar with the particulars of waterparks, but who are familiar with hotel operations.

Lenders we interviewed are looking for an equity infusion of 20 percent to 50 percent of value in addition to solid securitization of the loan amount.



SUFFICIENT COLLATERAL AND CAPITAL

- The proverbial 'skin in the game' needs to be clearly evident in the form of equity and a personal guarantee. Lenders we interviewed are looking for an equity infusion of 20 percent to 50 percent of value in addition to solid securitization of the loan amount. Typically, lenders require a higher equity contribution for an indoor waterpark resort loan than for a more traditional hotel loan.

Each of these characteristics carries weight in the decision to lend. Prudent developers will analyze their own strengths and weaknesses and determine how each of these characteristics can be enhanced to provide the lender with the best, most solid development team for the proposed project. The lender is searching for confidence in the ability of the developer to repay the loan.

Lender Characteristics

If a lender is willing to initially consider your project, then there are several attributes that, if present, will help generate a potential positive lending decision.

FAMILIARITY

- How well does your lender know the market in which your waterpark will operate?
- What is the lender's level of expertise or experience in waterpark and/or hospitality operations?

UNDERSTANDING THAT CASH FLOW IS KING

- Lenders require the property's projected cash flow to be sufficient to easily cover the projected debt payments. Cash flow projections must be clearly defined and have reasonable bases. The lender will scrutinize the financial projections and pro-forma.
- Lenders utilize the net income to determine the debt coverage ratio for the

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loan, which typically ranges from 1.25 to 1.5. If the ratio is surpassed during the term of the loan, then the lender could call for an infusion of cash to bring the loan amount back within terms of the note. The ability to do this on the developer's part confirms the strength of the developer.

Waterpark Project Characteristics

Waterpark projects are family-oriented leisure properties that have multiple layers of complexity in regards to revenue generation and operations. The following points outline the broad-based characteristics of these properties:

TYPE OF WATERPARK

Hotel & Leisure Advisors defines waterparks as follows:

- An **OUTDOOR WATERPARK** is a facility offering three or more waterslides and other aquatic features.
- An **INDOOR WATERPARK RESORT** is a lodging establishment containing an indoor aquatic facility with a minimum of 10,000 square feet of indoor waterpark space and inclusive of amenities such as slides, tubes and a variety of indoor water play features.
- A **STANDALONE INDOOR WATERPARK** is an aquatic center without an attached hotel, having a minimum of 10,000 square feet, inclusive of at least three amenities such as slides, tubes and a variety of indoor water play features.
- A **RESORT HOTEL WITH OUTDOOR WATERPARK** is a hotel with three or more water play features, such as slides, leisure rivers or wave pools.

BRANDING

- Many of the early waterparks and indoor waterpark resorts were independent properties. In recent years, franchised indoor waterpark resorts have become more common, but independent properties still dominate the market.

OWNERSHIP

- Interest rates and finance options for public waterpark projects tend to be lower than private. In 2019, only three private outdoor waterparks opened, compared to 12 municipally-owned outdoor waterparks.

PERFORMANCE

- For indoor waterpark resorts in equivalent markets, most perform better in occupancy and ADR than hotels that do not have indoor waterparks. This fact, on the surface, provides the foundation for a project that is feasible. However, there has to be enough revenue from various sources at the resort to justify the expenses. The bottom line net income depends highly upon the expertise of the management team and its ability to manage the resort's revenue and expenses.

Challenges In Financing A Waterpark

Waterpark development continues in the United States, with development costs for both indoor and outdoor waterparks increasing due to higher construction and labor costs, which are affecting a wide range of commercial development.

Financing outdoor waterparks can be difficult because:

- They are expensive to build: An outdoor waterpark can cost between \$1 million and \$8 million per acre to build.
- They carry seasonal risk: Outdoor waterparks are typically only open in the summer, and revenues can be dependent on the weather. A particularly rainy summer can affect revenues by upwards of 25 percent or more.

Indoor waterpark resorts are both a hotel and an amusement attraction. Below are characteristics of these unique properties that make financing them difficult:

LARGER SCALE AND GREATER COSTS

- They are bigger: Indoor waterpark resort projects are generally larger in scale and require larger development loans.
- They cost more to build: The development costs for an indoor waterpark resort are typically much higher than for many hotel properties. Most properties can cost between \$300,000 and \$600,000 per available room, inclusive of the full-service hotel and indoor waterpark costs.

HIGHER RISK

- They are hotels: Hotel income, which relies on daily variations in occupancy, is less stable and predictable than income for properties secured by long-term leases such as offices or apartments. Therefore, they may be viewed by lenders as a higher-risk situation.
- They are amusement facilities: The addition of an indoor waterpark to a hotel creates more of an entertainment destination, and, in spite of the success of many existing indoor waterpark resorts, some bankers perceive amusement facilities to be riskier than other types of commercial property.
- There are not many of them: The number of indoor waterpark resorts which exist in the United States is quite small—approximately 143 with indoor waterparks over 10,000 square feet as of May 2020. Therefore, lenders are generally less familiar with the dynamics of these properties. A developer may need to spend extra time to educate a lender when trying to acquire a loan.
- Seventeen indoor waterpark resorts closed in past ten years due to financial challenges; however, only four of these occurred in the last five years. These were all smaller properties with indoor waterparks less than 45,000 square feet.

BRANDING

- Developers find it easier to obtain financing for franchised properties than for independent properties because lenders tend to view franchised properties as more economically stable and less risky.

Overcoming The Challenges

A developer may counter these difficulties in obtaining financing by preparing a comprehensive package of documentation for a lender. A developer should consider the following items when putting together a comprehensive loan package.

LENDER EDUCATION

- A loan officer's familiarity with both amusement-related properties and the hospitality industry are vital. An educated hospitality lender well-versed in waterpark resort projects will alleviate a lot of consternation and wasted time for the

developer of an indoor waterpark resort project.

- Another aspect of lender education is market familiarity. A lender is more willing to lend in their own backyard as they have insights into the local markets, which supports the trend toward regional lenders as a viable option for financing. However, our discussions reveal the basic operational understanding of a waterpark is just as important as local market familiarity.

WATERPARK FEASIBILITY STUDY AND APPRAISAL

- As the foundation for a developer's loan package documentation, a comprehensive feasibility study will describe both the physical and economical characteristics of the proposed project. In addition, a well-documented appraisal will analyze construction costs and the market feasibility of the waterpark in determining the market value. Together, these documents, completed by experts in the waterpark industry, will provide the lender solid information on which to base prudent and informed financing decisions.
- A thorough feasibility study will provide projections of revenues and expenses by outlining industry trends and successes. It will be market specific and realistic in its bottom line net income projections.
- Projected strong financial performance combined with the most effective revenue streams and accurate development costs do not necessarily make a good deal for a lender. The lender is looking for the borrowing strength of the developer; the operational acumen of the waterpark operator; the strength and cohesiveness of the business and marketing plan; and the personal guarantee of the borrower.

TIMING

- Support material and data for a waterpark development contained in a feasibility report needs to be current. In 2018 and 2019 a number of projects were put on hold and have been shelved. Like prescription medication, a feasibility study has a shelf life. The shelf life of a feasibility study expires within six to nine months of the study's initial reporting date. It could even expire sooner, depending upon the market in which the project is located, as well as other external circumstances. Going to a lender with an outdated report or with piecemeal data, does not put the developers best foot forward. The best practice is to update any expired report before shopping the project to lenders.

A developer should have a well-organized, professional loan documentation package that communicates all performance aspects and physical characteristics of the proposed waterpark project to the lender in order to educate potential lenders about this area of real estate development.

While there are interested lenders who are looking at waterpark development projects, developers may have more difficulty finding the right fit for their individual projects. There are relatively few lending institutions actively soliciting these types of projects. For 2020, we predict that lenders may be hesitant to invest in leisure and hospitality projects until the COVID-19 pandemic resolves and a vaccine is developed. However, investing in a proposed project in 2020 would allow that project to open in future years after the economy gets back to normal.

Conclusion:

The financing environment for waterparks will be difficult in 2020, particularly due to the COVID-19 pandemic. However, these difficulties can be overcome for a solid project from a credit-worthy developer with a well-documented market feasibility study and an appraisal report, which fully explains the market dynamics and income potential for the waterpark project and serves to educate the lender. Developers need to be savvy and dynamic, understand their markets and be willing to stand behind their projects with equity or a guarantee. These types of developers, who are well prepared and diligent, will increase their chances of attracting financing in a difficult lending environment. •

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