

Where's the Money for Hotels and Waterparks?

A Developer's Guide to New Ideas, Feasibility & Funding

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November 2010 During the fourth quarter of 2010, it looked like the hotel and leisure industries were making an economic recovery in the USA and around the world.

Hotel occupancies were up over last year, but hotel room rates continued to drop --- indicating the road to recovery would be a long hard road. Museum and small attraction attendance was up but people were spending less money. Some major theme parks and regional outdoor waterparks reported gains in attendance, while others saw a decline.

The road to a rapid economic recovery was flawed by a lack of jobs and cautious consumer spending --- due to paying down credit card debt and building up saving accounts. Mistrust of major institutions, such as banks, Wall Street, corporations, unions and government, continued to anger many people who voted out incumbents at the ballot box.

Before the world's travel industry can rebound, consumer confidence must return.

What's the Market for Developing New Hotels and Waterparks?

Airlines continue to mothball their airplanes and offer fewer flights. Gasoline prices are stable for the foreseeable future, but families are taking shorter trips, staying closer to home. Smaller attractions are doing better, but many hotels are near default. Hotel bankruptcies and foreclosures continue to rise. There is a TON OF MONEY sitting on the sidelines waiting for a green light (consumer confidence) to invest. New private equity funds are forming to buy troubled properties, but they extract a high price from sellers. Banks continue to say no to new hotel construction --- even to their well-known, credit-worthy customers.

So What's the Good News?

- Cash is king! It is a buyer's market!
- The good news is it's cheaper to buy a hotel or waterpark than it is to build one.
- The good news is there are many hotel or waterpark owners that are looking for partners and willing investors with cash.
- When you've got cash, you can go shopping for hotels, waterparks, theme parks and attractions whose owners have over-extended themselves.

What Are the Opportunities?

- You can scale down your project from all-new construction to acquisition-renovate-reposition. Fifty million dollar projects are hard to finance today, but a \$5 to \$10 million project is a whole lot easier. With a smaller project you can seek a guarantee from the Small Business Administration. Hurry! You may be able to take advantage of New Market Tax Credits, Recovery Zone Facility Bonds, government-backed bonds, loans and grants before they expire.
- Develop your dry side! Waterparks are expensive to build. But you can expand your hotel or resort by adding a less-expensive family entertainment center (FEC) rather than spend money on more-expensive water features and rides. For example, in Wisconsin Dells, Kalahari Resort owner Todd Nelson built a \$20 million family entertainment center during the recent recession rather than spend even more money on his indoor-outdoor waterparks. He achieved the desired WOW factor by spending less money.
- You can buy a tired hotel in a great location at a bargain price, renovate it, add an indoor waterpark and create a family destination for a lot less money than building a brand new hotel waterpark resort.
- If you've got cash and want to enter the business, start talking to hotel owners in your area. Determine their financial status and their need for an equity partner. If they have vacant adjacent land, you can spark their imagination with the idea of an indoor waterpark or family entertainment center.
- You can add a major WOW factor to your hotel or resort by adding a treetop canopy tour, a zipline or a ropes challenge course. A high-quality canopy tour or zipline will cost anywhere from \$250,000 to \$1,000,000 but it will give you a competitive advantage, and it will be easier to finance than a \$50 million resort. You can install a ropes course for \$100,000 to \$300,000 and offer a new attraction without having to finance millions.
- You can buy or lease a worn-down, city-owned pool and convert it into a commercial waterpark.
- You can buy or lease an old vacant warehouse and convert it into an indoor mountain bike park.
- You can buy or lease an old bowling alley or roller skating rink and convert it into a state-of-the-art family entertainment center.
- You can convert an outdoor attraction with a 100-day peak season into an indoor attraction with a 365-day year round business using new high-tech structures and enclosures.

Got an idea you want to develop?

Before Acquisition, Every Developer Needs Two Things

Whether you are building a new \$50 million waterpark resort in boom times or adding an indoor waterpark to a hotel you bought for 50-cents on the dollar during the recession, you still need two major documents:

1. Market Analysis & Economic Feasibility Report
2. Request for Debt & Equity Funding

The market analysis quantifies the demand for what you want to do and shows you what the competition is offering. The economic feasibility report makes sure you understand all the risks and calculates your potential revenue, expenses and cash available for investors and lender. The request for debt & equity is a package that asks for the money, presents the project and shows how you are going to pay back the money you borrowed.

Both documents must be complete and professionally-prepared.

Market Analysis & Economic Feasibility Report

Most hotel waterpark developers understand the importance of having a feasibility report. But a few don't. First of all, investors and almost all lenders are going to require a feasibility report from an objective, third-party source. The few developers that proclaim, "We don't need a feasibility study!," are most likely amateurs filled with both arrogance and ignorance -- like the accused acting as his own defense attorney in a trial.

Developer's Feasibility Consultant vs Lender's Appraiser

Oddly enough, the feasibility report is the one thing that protects the developer from unknown risks. To mitigate risk, the lender hires an appraiser to value the property. So why wouldn't the developer hire an objective, independent consultant to determine economic feasibility of the project and reduce the developer's risk of failure?

The developer need not hire an appraiser to do his feasibility study. The bank will hire an appraiser later at the developer's expense when the loan is considered. The developer needs a feasibility report produced by a qualified consultant. The developer's consultant and the lender's appraiser should NOT be the same person or firm.

All-New Construction vs Expanding Existing Facilities

In the boom years, most feasibility reports involved a project that was all-new construction. But in today's financial environment, any feasibility report is more likely to involve an existing property. In today's market, for example, a developer would likely buy a hotel at auction for 50-cents of its value or outstanding loan. The developer might want to *add a box* (construct a new indoor waterpark on adjacent vacant land) and connect it to his existing hotel. Today,

the developer requires a feasibility report that determines the impact of adding the new indoor waterpark on the existing hotel. Therefore, the feasibility consultant must first establish a baseline of performance for the existing hotel, then overlay the impact of adding the indoor waterpark upon revenues, expenses, net income and cash available for debt service on the new money borrowed.

Feasibility Reports for Outdoor vs Indoor Waterparks

While outdoor waterparks are very different from hotels with indoor waterparks, the feasibility process and the feasibility report are basically the same. While weather affects the outdoor waterpark more than an indoor waterpark, the same basic questions must be answered to determine the project's financial success.

Here is an outline of a typical Economic Feasibility Report:

Executive Summary

1. Nature of the Assignment
2. Site & Surrounding Area
3. General Market Trends
4. Complete Supply Analysis
5. Demand Generators & Sources of Revenue
6. Industry Outlook & Trends
7. Product Recommendations: Design Concept, Facility Configuration, Ownership, Branding, Management & Marketing
8. Forecast of Future Performance

Executive Summary

The professionally-prepared Market Analysis & Economic Feasibility Report will summarize the results of each of the eight sections of the report in an Executive Summary of 8 pages or less --- including the financial spreadsheets. Investors and lenders will spend little time reading the developer's feasibility report, so the consultant must convey all pertinent information (both the sizzle and the steak) in the Executive Summary.

Nature of the Assignment

Questions include:

- Who is the client? Individual, partnership, corporation, bank, insurance company.
- What is the client's core competency? Related expertise?
- Who is on the development/ownership/management team?
- Briefly, describe the site. Vacant land? Existing business?
- If existing business, establish baseline of history to current financial performance.

General Market Trends

Questions include:

- Compare the proposed market with similar markets, ie Wisconsin Dells, Orlando.
- Compare the demographics in bands from 5 miles to 250 miles.
- What's the population, # households, # age groups, # income levels?
- Who are the major employers?
- What businesses have entered or left the market?
- What is the volume of airline passenger traffic? Origin feeder markets?
- What is the water, rail, truck and bus traffic?
- What are the automobile traffic counts in the area?
- What are the growth trends for industrial space, office, retail and residential?
- What is the attendance at area tourist attractions?
- What is the attendance at area convention facilities?
- What are the weather and rainfall patterns?
- Conclusions

Site & Surrounding Area

Questions include:

- What is the site selection criteria?
- What is the availability and price of sites?
- Compare and rank alternative sites. Preferred site?
- Describe the site in terms of location, size, shape, elevations, ground cover etc.
- Where is the site? Country, state, county, city? Highways, roads?
- How easy is the access to the site?
- How good is the visibility?
- Proximity to demand generators?
- Where is the access to water, sewer and other utilities?
- What site preparation will be needed?
- What are the surrounding area land uses.
- Conclusions

Competitive Supply Analysis

Questions include:

- Who are the primary competitors for hotels, waterparks, attractions, entertainment?
- What is the profile and performance of each competitor?
- What is the value and price positioning of each competitor?
- What are the proposed additions to and deletions from the competitive supply?
- What position among the competitive set can your facility occupy?

Demand Generators & Sources of Revenue

Questions include:

- What is the demand for lodging, dining, conferences, recreation & entertainment?
- What are the attendance figures for hotels and waterparks in the area?
- What is the natural drawing radius by air and by car for your facility?

- What are your feeder markets and driving distances?
- What are # families, # kids <14age, # income levels by 5 mile to 250 mile bands?
- What is the schedule for major events and festivals?
- What is the schedule of public schools in session?
- What is the past to present visitor and convention growth?
- What is the quality of the destination marketing organization?
- What is the # occupied room nights for the proposed hotel?
- What is the # of attendees for the indoor waterpark?
- What are the average room rate and average ticket prices?
- What are the revenues for rooms, food, beverage, conferences and waterpark?
- Conclusions

Industry Outlook & Trends

Questions include:

- What are the lodging industry performance trends? Occupancy, average room rates, revpar, room revenues, supply and demand for nation, region, state, city and competitive set?
- What are the waterpark industry performance trends? Outdoor waterparks, hotel indoor waterparks, theme parks, family entertainment centers for nation, region, state, city and competitive set?
- What are the performance trends for the restaurant industry, conference industry, recreation industry and entertainment industry?
- What are the growth trends for each industry?
- Conclusions and Future Trends

Product Recommendations: Design Concept, Facility Configuration, Ownership, Branding, Management & Marketing

There's an old saying: "Find out what customers want and give it to them, and they will beat a path to your door!" If you want to have a successful family resort that appeals to Dad, Mom and the kids, add a golf simulator for Dad, a spa for Mom and an indoor waterpark for the kids. It means knowing your different customers and understanding their different needs and preferences. It means designing your product to satisfy those needs and preferences.

What happened to ski resorts when snowboarding became an Olympic sport?
 What happened to hotel conferences since web-based, real-time video meetings emerged?

Business owners had to adapt their operations, marketing and even their facilities to meet new demands. Product features and benefits must satisfy customer needs and preferences or you will go out of business --- sooner or later. You must adapt and reposition your facilities to remain in business.

When the economy shifts, marketing and facilities must change. How can you anticipate a recession, deal with it and profit from it? Track future trends. Watch for changes in your

customer mix and customer types. Experiment with new concepts and test the results. Put your plans into action. This is what this section of the feasibility report covers.

Questions include:

- What are the profiles of the target customers for this facility? Customer mix?
- What are their needs, wants and preferences?
- How many hotel rooms should be built?
- Are the family suites big enough to accommodate six persons?
- How big should your indoor waterpark be?
- How many waterslides should be installed?
- How can your waterpark be configured for different activities by age group?
- What should you name your hotel and waterpark?
- Should you affiliate with a brand name or go independent?
- What are the best hotel franchises for an indoor waterpark?
- Is the ownership entity capable of managing the facility?
- Who are the best management firms that understand both hotels and waterparks?
- Is it possible to accommodate both business suits and swimming suits?
- Should you open your waterpark to room guests only or sell waterpark day passes?
- Who are the resort master planners and aquatic design-engineering firms that understand hotel waterpark resorts?
- Where can I find drawings and layouts of similar facilities?
- Where can I find an equity partner?
- Who's got money to lend for hotels and waterparks?
- What are your next steps?

Forecast of Future Performance

This is the final section of the feasibility report for a hotel waterpark resort. In today's financial environment, you are probably buying a hotel at a bargain price rather than building a new hotel. Let's say you want to build an indoor waterpark and attach it to an existing hotel. With a renovation, rebranding and repositioning, you envision a successful property with a balanced customer mix for higher revenues and a lower break-even point.

Your feasibility consultant has produced a daily occupancy calendar for the next 365 days of the year as well as the next five years. He has determined the impact of adding an indoor waterpark to your hotel's P&L. Indoor waterparks have a positive impact on hotel room sales, room rates and room revenues as well as food & beverage revenues, snacks, gifts and souvenirs.

The feasibility report establishes your new waterpark department with projected revenues, payroll and aquatic supplies.

Indoor waterparks also generate additional expenses, especially for energy and maintenance and insurance. These undistributed expenses are carefully calculated using the resort P&L format.

Near the bottom line, you will find Amount Available for Debt Service. This is the amount of cash you have available to pay principal and interest on the money you borrowed to build the indoor waterpark you attached to the existing hotel you bought at auction for 50-cents on the dollar.

Next line is your annual debt service payment. Finally, the bottom line in the feasibility report is your debt coverage ratio --- the amount of cash available to pay your debt compared to your actual debt. In a recent survey of hotel lenders, they require debt coverage ratios from 1.4 to 1.5. This means you must generate one and one-half times the debt service payment in cash or the lender may require a cash infusion from the developer.

Hotels with indoor waterparks perform better in terms of occupancy, average room rates and RevPAR than hotels without indoor waterparks. If you have a lender that understands this, you can shift your strategy away from all-new construction. Find a bargain-priced hotel that lacks leisure demand and consider adding a box --- you know, attaching an indoor waterpark. With less money invested, you will have a better chance at success as you ride out the economic recovery. Hire a professional to produce your Market Analysis & Economic Feasibility Report.

Request for Debt & Equity Funding

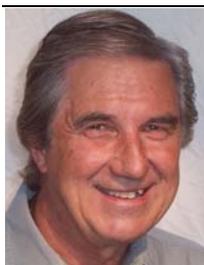
With your feasibility report in hand, your next step is to prepare a Request for Debt & Equity Funding. It is the second major document you need before you start digging. Don't go shopping for money without it! The secret to producing a great package is to include what investors and lenders want to see and leave out what they don't want to see. Here is a sample outline of 13 things to include in your Request for Funding:

<i>Overview of Project</i>	This section provides the lender with a description of the hotel waterpark resort project, size and location.
<i>Proposed Loan Terms</i>	This section will identify the borrower, ownership group, partners, construction loan amount and percentage of project cost, permanent take out loan amount and percentage of project cost, terms sought, amortization sought, interest rates requested, collateral, repayment and the purpose of the loan.
<i>Market Analysis & Economic Feasibility Report</i>	This information is necessary to validate the future forecast of revenues for the proposed project. Market strength, competitor information and lodging demand information will also have to be validated.
<i>Utilization</i>	This section will outline the first five years of occupancy, average room rate and REVPAR. The financial analysis of the project will review various other revenues, expenses and fixed charges resulting in projected Income Available for Debt Service.
<i>Franchise & Management</i>	This section will include a statement regarding the impact of a

	franchise brand on the project, an executed copy of the franchise agreement, information about the management company and an executed copy of the management contract.
Room Schedule & Schematic Design	The preliminary architectural drawings and guest room layouts are included in this section after they have been reviewed and modified if necessary.
Use of Funds & Equity	An itemized Use of Funds will be provided here, including the itemization of expenses surrounding the project --- including land acquisition, infrastructure, refurbishments, additions, new construction, and architectural, engineering, development, furniture, fixtures, equipment (FF&E), operating capital and pre-opening costs. Equity is identified.
Valuation Analysis	Valuation analysis will follow the Income Capitalization Approach with the appropriate Discount Rate and Capitalization Rates.
Debt Coverage Analysis	This section will outline the Cash Available for Debt Service, the Debt Coverage Ratio, and Return On Investment through the first five years of the project.
Resumes of Partners	Resumes of each partner or borrower are included in this section.
Articles of Incorporation	The executed Articles of Incorporation, LLC or LLP agreement are included in this section of the report.
Borrower Financial Statements	The current financial statements of every person identified as a "borrower" is included in this section of the report.
Borrower Tax Returns	The previous three years of tax returns from each "borrower" are included in this section of the report.

Final Thoughts

- Scale down the size and scope of your project.
- Find a great hotel at a bargain price and buy it.
- Add an indoor waterpark or family entertainment center to capture the leisure market.
- Renovate, rebrand and reposition.
- Hire an objective, independent hospitality-leisure consultant to help you.
- Get a Market Analysis & Economic Feasibility Report to prove your case.
- Put together a Request for Funding.
- Go shopping.



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