

Understanding the lending process



Jerry Merola

Financing your new entertainment project: Is the process really that difficult?

Let's face it, unless a wealthy uncle decides that you really deserve to inherit the entire oil and natural gas fortune, chances are that you'll be relying on creditors and lenders to finance your future business opportunities.

Some see the act of obtaining bank financing an impossible task, but the fact remains that banks, and lenders in particular, are in the business of loaning money to balance their own obligations.

How then do we create a marriage between those that need the funds and those that lend them? The key lies in understanding the metrics of the lending business and preparing yourself for what is often a tedious and stressful process.

HOW THE LENDING PROCESS WORKS

First, let me provide full disclosure. Prior to launching my consulting firm in 1995, I was a commercial lender for 10 years, with a specialty in the sports, entertainment, and recreation segment of the industry.

During that time, I was able to review and analyze nearly 2,000 funding transactions, all of which took place right here in the good 'ol United States.

The experience provided me with an insider's view of how lending committees, bank boards, and federal regulators view loans within a bank's lending portfolio, and ultimately what it would take to get a new transaction approved.

It's important to understand that banks are not in the risk business. That segment is reserved for the loan sharks, bookies, and mobsters. Instead, banks are interested in providing funds



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to business developers and owners under a low-risk formula, seeking only moderate rates of return for the principal lent.

It's also important to note that banks have a fiduciary responsibility to their depositors to lend depositor funds with reasonable care. When it comes to "start up" businesses, banks know that new business formats have the greatest potential for failure, as the business concept and management acumen may not be a proven quantity at the time of underwriting.

As a result, banks will scrutinize start-ups much more carefully, and may seek both repayment and collateral support beyond the project principals and business assets that will be acquired. In essence, banks are simply covering their downside, as a bank's business strategy never involves placing its borrowed principal at risk.

FORMING LENDING REQUESTS

Now that we know the parameters

that banks must operate within, we can position our lending requests to reduce both perceived risk and unexpected outcomes.

How might you ask? Well, there are many ways to bolster a credit application, including the offering of a personal guarantee, an additional lien of personal or owned real estate, or the pledging of a marketable securities account.

In addition, other options are available, including a "capped" guarantee pledge from a family member or business associate, a cross-collateralization of an existing, unrelated business owned by you, or the procurement of a government guarantee on behalf of the lender.

Wait, that last one sounds interesting, how do we get one of those? The answer lies with both the Small Business Administration (SBA) and The U.S. Department of Agriculture (USDA).

Just when you were convinced that the U.S. government wasn't doing much to spur the country's local economies, we stumble across perhaps the greatest single solution to the credit crisis. While the banks might be scared to death of your guaranteed-not-to-lose entertainment concept, the SBA and USDA offer a more favorable view.

When incorporated into a funding transaction, both the SBA and USDA can provide much needed support for a primary bank lender. Did you know that the SBA alone supported over \$12 billion in financing and bank guarantees in 2010?

Considering that the SBA's loan cap stands at \$5 million, it's clear that the SBA provided a staggering level of support for banks, and in turn, small business owners and developers.

PREPARING FOR THE LENDING PROCESS

Financing any business takes determination and focus. From the procurement of an independent mar-



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ket feasibility study to the drafting of a business operating plan, lenders need to know that you've considered both the upside and downside of your proposition.

After all, not every business concept will be successful, and the banks must ultimately choose those that they believe have gone the extra mile to reduce both perceived risk and potential for failure.

Developing a business case carries with it some expense as well as some sweat equity. Rest assured that lenders have little desire to fund an interesting idea that has not been put to the test on paper.

I often hear from new entertainment developers who are inquiring as to whether there is a preferred national lender that is sympathetic to the entertainment industry.

The fact is, if one existed, they'd quickly develop an unhealthy concentration of loans to this particular industry and then appropriately diversify into other segments.

While no one lender exists for the entertainment sector, I can share that local financial institutions are responsible for funding the lion's share of the entertainment projects we see in operation today.

Why is this? Local lenders are better able to understand the needs and opportunities within a marketplace, and can often perform a strong level of due diligence on their own. More importantly, local lenders have the advantage of getting to know the project principals, their backgrounds, and their common relationships. This level of personal recognition can go a long way toward structuring a suitable lending transaction.

As I've said for years, lending is a "human" thing, with people helping people. Building a rapport with a banker can go a long way in getting that banker to go to bat for a project that she or he believes in.

WHAT TO EXPECT

Lending requires certain elements to exist in almost all cases. For starters, you should expect to be asked to provide a personal guarantee pledge. What does this mean? Essentially, if the business was to default on the bank note, you would be asked to become personally responsible for repayment of any outstanding principal.

It's fair to say that almost no level of commercial lending is done today without a full or partial guarantee on behalf of the project principals. Providing a personal guarantee makes a clear statement to the lender that you're standing behind your business plan.

Next up is the likelihood of providing additional collateral. In many cases, a bank will ask for a secondary lien on your personal residence or perhaps another real estate asset owned by you.

In short, despite the real estate conundrum going on in this country, banks still favor real estate as their



collateral of choice. Do expect to permit the bank lender to file UCC liens on all assets that your business will acquire, and anticipate that the lender will restrict your ability to buy additional assets without their consent.

In many cases, you'll also be asked to meet specific financial covenants year after year, as the bank will continue to monitor its loan through analysis of your company's financial statements.

In virtually all circumstances, you'll be asked to provide an equity contribution to the project of anywhere from 10-35 percent, largely based upon the existence of a government guarantee as well as the lender's comfort level with your business concept, experience, and collateral position.

HOW LONG WILL IT TAKE?

Borrowing funds for a business transaction should never be viewed as a quick process. Completing a lending transaction into today's economy can easily take six months to complete, half of which may represent the underwriting process.

The search for an agreeable lender may require additional time, as not every lender will find your concept or lending package appealing. Perseverance generally pays off in the lending business, provided your business strategy is sound and your offering package well developed.

Don't be discouraged if you're not achieving success in the early stages, as it's likely that your offering package will require fine-tuning along the way.

If your lending request is turned down by a particular lender, be sure to request an official declination letter, as the lender is required by law to identify the key reasons for the denial. Once known, you can further refine your package in an effort to reduce such concerns, and then

launch a new request with an alternate lender.




USE AVAILABLE RESOURCES

Funding often requires several steps, and often involves several sources. From vendor finance companies, leasing groups, primary lenders, community development grants, and government guarantee programs, a project's overall financing goal can be achieved by blending some or all of these resources together.


Focus your energies on developing the most effective financing

package available, and surround yourself with professionals that can provide lenders with reasonable assurance of your success. Start the process early and always remember: financing exists; the key is understanding how to play the game. ▲

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