PAYING FOR PROJECTS

Dr Wolf Vierich outlines the dos and don'ts, some golden rules and a plethora of pitfalls to avoid when it comes to project finance

THE number of start-ups, particularly in the global land-based casinos sector, remains high.

This is compatible with all other elements of the international entertainment business. In addition to the traditional hazards of any investment, however, there is growing evidence of fraud.

Those seeking to invest in what they may hope will lead to a high return on their capital are too often "hijacked" by skilful con artists who fleece them of high levels of their available resources before disappearing without trace.

It is a problem, says Wolf Vierich, which is particularly prevalent in the growing Asian casino market, but in virtually every aspect of entertainment development and his company the Vitala Group - an expert in project management - has amassed a dossier on the industry's most "dodgy" characters.

In the following specially-commissioned article, Vierich outlines the dos and don'ts of project initiation for those considering investing.

THE DOS AND DON'TS IN CASINO START-UPS

Few succeed in obtaining project finance, not so much for lack of enthusiasm and homework, but rather by failing to understand how project finance works, not to mention the major potential traps and pitfalls one can encounter.

The purpose of this article is to assist those who believe they have created a tourism/leisure/entertainment project worthy of receiving project finance from external sources.

MISCONCEPTIONS

Misconceptions which often lead to failure include the belief that a project finance application is decided upon solely by financial terms and/or the applicant's assets available for collateral cover. In fact, there are other factors at play and it is important for the borrower to seek counsel on these matters.

Additionally, there are the "sharks" or "scam artists" waiting in the wings to obtain fees and up-front payments without having the slightest intention (or the qualifications) to deliver on promises.

The Vitala Group of Companies has established an ever-growing database of those fraudsters, numbering over 14,700 individuals and over 7,500 international corporations.

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INFORMATION FLOW

Investors and/or lenders would like to know about your status and role in the lending process. Here are a few major questions you should expect to answer:

- Are you just looking for project finance or will you actually play a role in the future project? What kind of role will you play - shareholder, manager or contractor?

- What does a financing source want/need to know about you, the applicant, the person(s), the company(ies)?

- Are you willing to provide personal guarantees when asked to do so? Saying "no" will put the applicant into an unfavourable position from the start, as it appears that the applicant has not much faith in his own project.

- Is it your intention to use the loan for this project only or do you intend to first pay back other past financial commitments?

- What are your assets? How much are you worth? Investors/lenders do not like to negotiate with applicants for multi-million dollar amounts without them demonstrating some past success. This is referred to as "financial gearing." Investors/lenders like to see a "minimum financial participation" in the overall risk of a project.

- What sort of qualifications/past professional experience do you bring to your project? Is there a relevance to be drawn with your new project? Do you have a management team you could propose or do you rely solely on future sub-contractors to make this happen? Investors/lenders welcome past operating and profit and loss experience attained within a commercial environment.

INTERNATIONAL PROJECT FINANCE CRITERIA

International investment philosophy has shifted considerably during the last few years for a variety of reasons and a leisure developer seeking financing should take care to observe the following trends:

- Investors look for professionalism. Clearly defined design proposals must be accompanied by clear financial support documentation.

- Plans likely to attract future financing are, in all respects, well researched and valued. Projects that are not well documented and described will fail to cross the doorstep of investors/lenders.

- An obvious preference is given to those applicants who, in the past, have successfully developed a project and/or are able to show evidence of past senior management positions in relevant industries.

- What is your personal credit rating and those of your proposed future management members? Does it stand up to close scrutiny?

- People think in pictures and a financier is impressed by a clear, logically designed project. A set of feasibilities is the most effective tool to express the principal assumption on which a planned project is based.

OVERVIEW OF PROJECT FINANCE PRINCIPLES

In the past, funding was difficult mainly because leisure developments were untested commercial ventures and private developers and financiers were confused about what constitutes a leisure development.

In recent years, though, a number of well-known international leisure companies have been listed on the stock market and the public and financing community better understand their performance. So project proposers have an easier time, but they still have to present a persuasive package which fulfils the following set of principles.

The principal asset of any leisure project is the property and its value. Failure to exploit the maximum value of the property reduces the project's prospects of optimum financing. The key here is to have the professional opinion of a chartered surveyor available at the outset.

Success in raising funds for a leisure project requires greater attention to detail by the proposer than in most other market sectors, because of the lack of historic experience and comparisons. Project feasibility studies must contain the following at least:

- An explanation of basic assumptions made (an architectural design brief or your principal underlying concept ideas).

- Revenue inflow/cash flow forecasts covering the internationally accepted accounting period of 10 years, year by year.

- A concise methodology and operating philosophy of management, setting out the experience and abilities of proposed operational management.

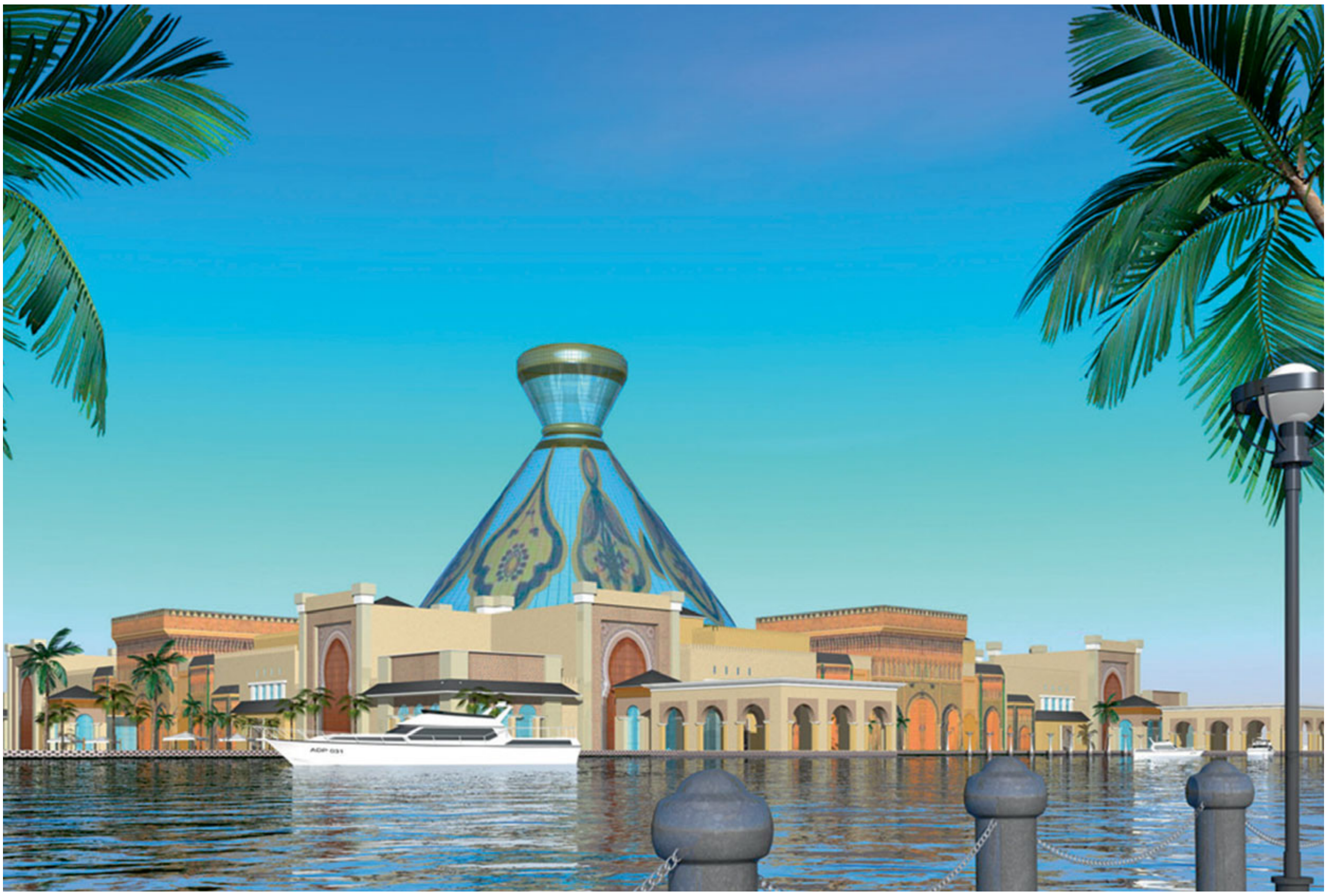
- A detailed description of the project, with a clear assessment of the target market.

- A sensitivity analysis showing the likely impact of changing demographics and assumptions about disposable income.

- Type of funding sought and forecast returns.

Special grant funding from local communities may be available if the project is likely to: produce increased tourism locally; provide a low cost user facility for schools, handicapped or unemployed citizens, etc; or increase revenue for surrounding ventures by attracting more traffic to the area.

/// "THE INVESTOR WILL SEEK EVIDENCE OF AN INDEPENDENTLY PREPARED MARKET STUDY, INCLUDING STATISTICAL IDENTIFICATION OF THE FEEDER MARKET, WHICH SUPPORTS THE PROJECT DESIGN AND BUSINESS PLAN" ///



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The investor will seek evidence of an independently prepared market study, including statistical identification of the feeder market, which supports the project design and business plan. Without it, he or she will not be able to assess risks adequately.

All the documentary evidence is crucial in obtaining successful financing, but equally important is the performance of the proposer.

An investor or financier likes to be convinced that the project will be developed "by people." The documentary submission creates a favourable picture of the developer and leads to personal contact to discuss a deal.

In that contact, management should be able to demonstrate knowledge of facts and the proposal's details, so as to exude competence and trustworthiness. This human element plays a large and probably decisive part in any financing proposal.

PRELIMINARIES OF SUCCESSFUL PROJECT FINANCING

Please note the questions you are expected to answer in a detailed and concise format in order to secure project financing:

A) Describe your project

- How to distinguish between "relevant" and "irrelevant" information required to assess a finance application?

- Who qualifies as a lender? What types are available? How do they work?

- The investor, not the banker, is the developer's key to project funding. Contact with him or her, through Wall Street or London, will not be easy given the intense competition in the equity markets. But it is not as difficult as it is often described.

- Investors are not dissimilar to company managers. They head pension funds, unit trusts or insurance companies, selling and buying shares for their shareholders. They simply require a return on their investment, which must balance all risks.

- Glossy and unnecessarily expensive presentations will arouse suspicion as regards the managerial abilities of the proposers.

- Reliance upon grants, tax breaks and other means of reducing finance requirements do not make the project proposal more attractive. Such contributions should be treated as bonuses.

- The importance of a unique selling point: does your project have at least one?

B) The market feasibility study

- Why is it needed? What is its purpose?

- This is an independent research document to verify information indicating clearly that you have a "niche market" available.

- "Market share" projects, i.e. when you are competing against an existing type of project (McDonalds, KFC, etc), are difficult to finance since their margin of profitability is limited.

- Who should be the author? A well-known and established research company.

- What should the document contain? The market feasibility study has to show, among others: A competition analysis (the existing competition surrounding your project location); demographic income groups; demographic age groups available; and demographic expenditure groups (the amount of money people are able to spend at your project after having met their basic domestic expenditure).

C) The financial feasibility study

- Why is it needed? What is its purpose?

- This is a cash flow model based on "revenue inflow" calculations, i.e. you can only borrow as much money as you can demonstrate a market for.

- What should the content be limited to? A comparison of future "soft" and "hard" costs, indicating the breakdown of your expenditure to show the liquidity ratios; soft costs are non-recoverable expenditure such as fees, consultants, licences, permits, attorneys, accountants, etc; hard costs can be partially liquidated, i.e. a building can be sold to another party although at a reduced value; a 10-year cash flow forecast, year by year; a 10-year profit and loss account, year by year; a 10-year balance sheet, year by year; 10 years' expenses and revenue assumptions, year by year; an investor's exit analysis (investors require to know when your project debts exit, i.e. when can they get their money back?); a financial risk sensitivity analysis, often referred to as a "break-even point" (investors would like to know what are your minimum assumptions to be able to survive operating on); and individual and combined internal rate of return as well as net present value calculations should be shown.

- How detailed does the information have to be? Investors like to be able to re-calculate your assumptions.

D) The management plan

- Why and when should this be prepared and issued separately? This management plan is distinct from other finance computations in as much as investors would like you to demonstrate the availability of "industry qualified senior management," i.e. the persons heading the enterprise should be able to demonstrate senior management experience in the project sector you are borrowing money for.

E) The development budget

- Why is it needed? What is its purpose?

- The development budget must contain a detailed summary of all expenditure to be incurred until project opening date, including various provisions and contingencies.

- The development budget's importance ceases the moment an operating budget becomes relevant (project opening). It is required for funds flow supervision.

- The development budget contains all forecasted and estimated values, covering items whose costs are not known at the time the development budget is established.

F) The environmental impact study and social impact assessment

- Why is it required and by whom?

- This is a requirement in most countries, including the European Union.

- The risk of the public or organisations objecting to resident and tourist noise, circulation impact, creation of traffic density, possible increase in crime in the city, availability of adequate police, fire, healthcare authorities - everything concerning human beings affected by your project - is too great a risk.

- Any such objections are extremely time-consuming and invariably result in negative public relations and prove to be costly to define.

- Eco mitigation will be of prime concern for any chosen site.

G) Sponsorship

- In order to sell sponsorship, you must first understand what sponsors are looking for.

Sponsoring corporations measure the viability of a proposal by asking several questions, for example:

Will this programme increase the sponsor's market visibility?

Will involvement generate traffic at the sponsor's place of business?

Will participation increase the sponsor's retail sales?

Will association with this venue improve the sponsor's public image?

- In order to answer these questions, sponsors analyse the content of each proposal they receive to see if the benefits offered meet their marketing objectives.

- Demographics, psychographics, geographic strategies and return on investment are all factors that should be included. In addition, attractions seeking sponsorship will want to include a combination of benefits in their proposals.

- Sponsors may be interested in:

ON-SITE SIGNAGE AT THE VENUE

Sponsors can place banners, permanent signs and other logo-bearing items on display at your facility. Each time your customer sees the sponsor's name you have increased the sponsor's visibility. But you must be cautious about placement and legal issues regarding use of registered trademarks.

INCLUSION IN THE MEDIA CAMPAIGN

Logos in television spots, five to 10-second tag lines in radio commercials and couponing in your print ads are all valuable benefits to the sponsor who is looking to get his message out to more people. Media tie-ins can increase the sponsor's visibility, drive traffic and increase sales.

WEBSITE LINKS

Each day, more and more people catch web fever (the urge to sit in front of the computer or tablet for hours on end searching for facts and features on every subject under the sun). Corporations are spending a small fortune creating web pages to get their advertising message out to the public. By linking your customer to the sponsor's web page you provide yet another method of increased product exposure for your sponsor.

DATABASE ACCESS

The cost of purchasing mailing lists can be exorbitant. If you maintain a healthy database, listing names and addresses of your customers, that list will have a significant value to those companies targeting a similar demographic. Make sure that you know how this database will be used and that the intended use is appropriate for your customers.

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INVOLVEMENT IN PROMOTIONS AND SPECIAL EVENTS

The nice thing about a special event is that you have a captive audience. Sponsors seek participation in promotional activities and special events because they want a chance to make one-to-one contact with your customers. This increases brand awareness, enhances public image and, if their product is available at the event, can increase the chance for additional product sales.

TICKETS AND OTHER VIP PERKS

Sponsors use tickets and other perks as productivity incentives for their staff, sales incentives for their customers and to entertain VIPs and dignitaries. The nice thing about tickets is, on most days, they don't really cost the venue much. The doors are already open and the staff is already working. In addition, those customers who visit your facility using sponsor's tickets often spend money, increasing per capita income.

- If you want to be successful in your search for sponsors, it is critical that you take the time to research the marketing objectives of the corporations you plan to approach. This can be very time-consuming but it is well worth the effort.

- Because time is the greatest commodity and because finding sponsorship can be very taxing it is advisable to seek the assistance of a professional sponsorship development firm to guide you. Some companies will simply consult, offering you advice along the way. Others offer complete sponsorship services and will basically do the job for you.

- In addition to the time factor, a professional sponsorship company will be familiar with the terminology specific to its industry and will provide much needed expertise regarding the complicated legal considerations pertinent to sponsorship.

H) Construction cost estimates, quantity surveys and other assessments, tests and surveys

- When are they needed? These are required in most cases after a project loan has been obtained.

- They do not form part of a loan proposal since general cost estimates are already included in the financial feasibility study.

I) Loan applicant's costs

- Investors expect a borrower to take maximum risks.

- They expect the borrower to remain responsible for all the development costs, to cover: all feasibility studies; initial permits and

licences (if required); the architectural design concept; and their own mobilisation costs (flights, hotel, meetings, etc)

● The assumption of these costs is a clear indication to investors that they are dealing with a genuine loan application.

J) Other matters to consider

● There are numerous other matters investors would like you to consider when making a professional project loan application.

● These are, in the main: initial outline architectural master plan and final architectural master plan; grants research and applications; IT surveys (where relevant); and references on past projects completed.

● All of the above are the subject of the investors' due diligence process to be carried out upon each loan application.

K) What types of funding can developers hope to attract in this sector?

● There are two types of funding and often the overall funding packages are a combination of these.

● The first involves public funds. European city authorities are very often willing to assist a developer with financial assistance, in the form of grants or special low interest loans, provided the developer can satisfy the authority that the intended leisure development mixes with other existing local criteria, such as an add-on leisure facility near an existing retail or shopping complex, and benefits the local community in some way, perhaps by producing increased tourism or providing low-cost facilities for schools, handicapped citizens, unemployed people and so on.

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● Then, of course, the developer must also attract private investors, who require other types of guarantees.

● Investors are like company managers, yet rather than run companies, they head pension funds or insurance companies, selling and buying shares for their shareholders. The investor requires a return on his investment and that return must balance all risks involved.

K) Finally, the don'ts and other golden rules

● When you Google "project loans" on the internet millions of sources will appear. At least 90 per cent are dishonest and fraudulent operators whose principal aim is to enrich themselves as quickly as possible.

● Beware of those dishonest sources, so-called brokers and intermediaries.

● Here are some golden rules to protect you from losing your money to fraudsters:

a) Check whether they are legally registered as a company.

b) Google the names of their principal directors.

c) Do not succumb to sending any upfront payments or similar fees for things such as "insurance certificates, licences, etc."

d) No serious loan providers will ask for upfront payments of any kind other than refundable travel and hotel expenses, in order to verify your site location.

e) When you do not receive written proposals outlining the procedures required for your loan but receive instead a type of computer-generated run-down of basic financial explanations, it is time to abandon your search.

f) Check whether the parties you are communicating with are actually involved in the provision of project loans.

g) Bona fide brokers/dealers/providers of project loans are always prepared to supply written references. However, they will only do so once you have entered serious negotiations with them.

h) Enter into a NDNCA with the proposed provider before exchanging any communications.

i) Ask the provider for their standard terms of business. They should be able to demonstrate the rules governing your dealings with them.

j) Don't be bamboozled by the names of numerous corporations, law firms or accountancy firms.

k) Ask the provider what is required from you and what the costs are for this.

l) Ensure that your project ideas/plans/samples/descriptions cannot easily be copied by others until your ideas are legally protected.

Dr Wolf Vierich is chairman and managing director of the London-based Vitala Group, which has been advising investors in entertainment projects since 1983.

He was leader of the team nationalising Tanzania's hotel and tourism industry; regional general manager of the Inchcape Group's Middle East operations and Holiday Inn International Hotels' director of projects Europe, Middle East and Africa. He is an advisor to numerous national presidents and heads of state.

Vierich is a graduate from two West German hotel management schools and has studied widely in the US, majoring on contract and international trade law, economics and business management. He has also studied international project management at the European Centre of Management in Brussels and executive management at Cornell University, New York.

Vierich has strong analytical development skills combined with multinational practical management abilities attained in the international hotels and leisure industries. He lectures widely on the tourism industry. For his global achievements in the international tourism industry he was knighted by the German government in 2010. ❏