HOTEL & LEISURE ADVISORS

Financing Your Indoor Waterpark Resort

By David J. Sangree, MAI, CPA, ISHC

You have your plans and reports in hand and are ready to start your indoor waterpark resort. Where does the money come from?

Many indoor waterpark resorts are doing far better than hotels without indoor waterparks in equivalent markets in terms of occupancy levels and average daily rates. Despite this competitive advantage, financing your new indoor waterpark resort will be more difficult than financing a typical hotel or commercial building. Indoor waterpark resort projects are usually larger in scale and require larger development loans. Additionally, the risks involved in starting and operating an amusement-oriented resort property are higher than those involved in starting and running other types of properties. Also, if you are planning to start an independent property rather than a franchised property, you will have the additional challenge of overcoming the typical lender's view that independent properties are less economically stable than franchised properties.

This article characterizes indoor waterpark resorts and types of financing that are generally available. A discussion of the challenges to obtaining financing is followed by suggestions to overcome those obstacles.

Characteristics of Indoor Waterpark Resorts

<u>Size and Features</u>

Hotel & Leisure Advisors (H&LA) defines an indoor waterpark resort as a hotel facility connected to an indoor waterpark with a minimum of 10,000 square feet of indoor waterpark space with amenities such as slides, tubes, and play structures. Many hotels with large swimming pools claim to have an indoor waterpark; however, these do not fit our definition of an indoor waterpark resort and should technically be referred to as hotels with water features.

<u>Branding</u>

Many of the early indoor waterpark resorts were independent properties. In recent years, franchised waterparks have become more common, but independent properties still dominate the market. Franchised properties typically are smaller hotels which also target corporate demand while independent properties tend to be larger facilities which are focused on leisure demand.

Supply of Indoor Waterpark Resorts

The following table summarizes the current supply of indoor waterpark resorts in North America. The chart also indicates average room counts, waterpark size and the percentage of properties which are franchised.

Indoor Waterpark Resort Supply Analysis						
	Number of Resorts	Average Room Count	Indoor Waterpark Size (SF)			Percent
State			Average	High	Low	Franchised
Idaho	1	98	25,000	25,000	25,000	100%
Indiana	1	344	30,000	30,000	30,000	100%
Iowa	3	164	18,667	25,000	11,000	67%
Illinois	2	169	24,500	25,000	24,000	50%
Kansas	2	250	33,000	38,000	28,000	0%
Kentucky	1	81	10,000	10,000	10,000	100%
Massachusetts	1	260	10,000	10,000	10,000	0%
Michigan	7	198	29,714	58,000	10,000	43%
Minnesota	12	186	28,083	68,000	11,000	58%
Missouri	2	617	20,000	20,000	20,000	0%
New York	1	200	38,500	38,500	38,500	0%
North Dakota	4	186	13,250	21,000	10,000	100%
Ohio	4	361	47,250	80,000	33,000	25%
Pennsylvania	2	385	67,500	78,000	57,000	50%
South Dakota	1	150	30,000	30,000	30,000	100%
Texas	1	428	70,000	70,000	70,000	0%
Virginia	2	951	48,500	55,000	42,000	0%
Washington	2	111	10,000	10,000	10,000	100%
Wisconsin	31	222	35,552	225,000	10,000	19%
Total USA / Average	**80**	**282**	**31,027**			**39%**
Alberta	3	260	80,600	217,800	12,000	67%
Manitoba	2	148	10,000	10,000	10,000	100%
Ontario	6	375	41,667	90,000	15,000	50%
Quebec	1	222	10,000	10,000	10,000	100%
Saskatchewan	1	157	10,000	10,000	10,000	100%
Total Canada / Average	**13**	**232**	**30,453**			**69%**

Note: Resorts have a minimum of 10,000 square feet of indoor waterpark space
Source: Hotel & Leisure Advisors, August 2006

The growth of indoor waterpark resorts has been strong in recent years with 24 projects projected to open by year-end 2006. Many new indoor waterpark projects have been proposed at new resorts and existing hotels throughout the northern United States and Canada. As of August 2006, we are tracking 197 proposed indoor waterpark resort projects which include additions to existing hotels as well as new construction resorts. If all of these projects were built, they would total 41,510 new guestrooms with 8,242,240 square feet of waterpark space. However, most of the proposed projects are still trying to obtain financing.

Financing Indoor Waterpark Resorts

Indoor waterpark resorts have been financed through a variety of methods including:

- Traditional banks
- Investment bankers specializing in the hospitality industry
- Wealthy individuals
- Self-financed through cash flow of other properties
- Government backed loans and grants

To obtain financing for an indoor waterpark resort, developers need to have strong management expertise and character to demonstrate to the lender that they have the necessary experience for developing and operating the property. The developer needs to have sufficient collateral and capital so the lender can feel that the loan will be paid off. Most importantly, the property must have sufficient projected cash flow to easily cover the projected debt payments with clearly defined and reasonable bases for these projections. Lenders will scrutinize financial projections provided by a developer to determine their reasonableness and the resort's potential for success. The lender will utilize the appraisal as well as an analysis of construction costs in determining the prospective loan for the project.

David J. Sangree, MAI, CPA, ISHC interviewed various lenders and investors concerning the financing of indoor waterpark resorts in August 2006. The following chart summarizes the rates and types of financing commonly used with indoor waterpark resorts.

Indoor Waterpark Resort Financing Survey - August 2006		
	Construction Financing	Permanent Financing
Interest Rate (%)	8% to 10.25% Approximately 125 to 200 basis points over the prime rate	6% to 8%
Terms of Loan (Years)	2 to 3 years	5 to 20 years
Years Amortize	Interest only	20 to 30 years
Debt Coverage Ratio	1.2 to 1.5	1.2 to 1.5
Loan to Value (%)	50% to 80%	60% to 80%
Source: Hotel & Leisure Advisors, LLC		

Challenges in Financing an Indoor Waterpark Resort

Indoor waterpark resorts have proven to be more difficult to finance than typical hotel properties or other commercial properties. The difficulty in financing an indoor waterpark resort comes, in part, from the fact that it is both a hotel and an amusement attraction. Below are characteristics of these unique properties which makes financing them difficult.

<u>Scale</u>

- 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. Some properties can cost between $150,000 and $300,000 per available room when indoor waterpark costs are included. The indoor waterpark itself may cost from $200 to $500 per square foot of net indoor waterpark space.

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; therefore, they may be viewed by lenders as a high-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 more risky 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 - less than 100 with indoor waterparks over 10,000 square feet. Therefore, lenders are generally unfamiliar with the dynamics of these properties. A developer may need to spend extra time educating a lender when trying to acquire a loan.

Branding

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

Overcoming the Challenges

A developer may counter these difficulties in obtaining financing by preparing a comprehensive package of documentation for a lender. A thorough feasibility study will provide projections of revenues and expenses by outlining industry trends and successes. The study also educates lenders about this relatively new area of real estate development. A strong business plan illustrates the developer's expertise and commitment to success. A well-documented appraisal will analyze construction costs and the market feasibility of the resort in determining the market value. Together these documents provide the lender with solid information on which to base prudent financing decisions.

Typically, lenders require a higher equity contribution for an indoor waterpark resort loan than for a more traditional hotel loan. Our interviews with hotel lenders indicated that the climate is changing; lenders are beginning to look at indoor waterpark properties with more interest than they had in previous years. In spite of this growing interest, there still are relatively few lending institutions actively soliciting these types of projects. However, as more properties are developed and begin to show strong performance, we anticipate that financing will become somewhat easier. A case in point is the Great Wolf Resorts. Their performance has increased Wall Street's knowledge of this specialized area of the hospitality industry.

Conclusion: The financing environment for indoor waterpark resorts is currently difficult due to lack of lender interest, and larger equity contribution requirements. These difficulties can be overcome, however, with a well-documented market feasibility study and an appraisal report, which fully explain the market dynamics and income potential for the resort project.

This article appears in the World Waterpark Association's 2006 Development and Expansion Guide.

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