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Financing Challenges for Indoor Waterpark Resorts

By David J. Sangree, MAI, CPA, ISHC

Indoor waterpark resorts are a relatively new phenomenon in the United States and are spreading to new locations across the country. Many of the indoor waterpark resorts are achieving occupancy levels and average daily rates well in excess of hotels without indoor waterparks. Financing of new indoor waterpark resorts has proven to be more difficult than a typical hotel due to the size of the project and related development loan, as well as the increased risk inherent in an amusement oriented resort property. A well-documented appraisal is required to attain financing. The appraisal of an indoor waterpark resort has many similarities to the appraisal for a typical hotel property with some important differences in analysis and scope of the project. As an indoor waterpark resort is an entertainment based hospitality property, it has the potential to achieve substantially higher revenues than a typical hotel property although it also has additional risk inherent in its operation. This article will discuss methodology for preparing an appraisal on an indoor waterpark resort as well as financing for resorts in this difficult lending environment.

Indoor Waterpark Resort Overview: We define 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 and inclusive of amenities such as slides and tubes. Many hotels with large swimming pools claim to have an indoor waterpark; however, our definition of a 10,000 square foot minimum waterpark space restricts the use of the term resort to those facilities which have a variety of slides, pools and tubes. The following table indicates the current supply of indoor waterpark resorts in the United States.

USA Indoor Waterpark Resorts Supply Analysis

	Number of Resorts	Ratio	Average Room Count	Indoor Waterpark Square Footage Average	High	Low
Franchised	12	29%	242	18,425	51,500	10,000
Non - Franchised	29	71%	241	34,883	160,000	10,000
Total	41	100%				

Note: Resorts have a minimum of 10,000 square feet of indoor waterpark space

Source: US Realty Consultants, 216-221-9191 (August 2004)

Many new indoor waterpark projects have been proposed at new resorts and existing hotels throughout the northern United States and Canada. As of August 2004, we are tracking 70 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 13,347 new guestrooms with 2,949,980 square feet of waterpark space.

Methodology for an Appraisal

The purpose of a typical appraisal is to estimate the market value. Market value represents the most probable price which a buyer and seller would agree to in a sale transaction.

The scope of an appraisal for an indoor waterpark resort property involves the systematic research and analysis necessary to reach a value conclusion for the property. The initial step is to inspect the subject, neighborhood, and general market area. Market research should include data from public records, real estate specialists, governmental entities, real estate publications, owners/investors, and from management and hotel managers at comparable properties both locally and at other locations where indoor waterparks are successful.

A thorough market analysis of the local hospitality and indoor waterpark resort market should be included within the appraisal. Management of hotel and indoor waterpark resort comparables should be interviewed. If the property is proposed and will be the only indoor waterpark resort in the area, the appraisal should include a thorough analysis of other markets with indoor waterpark resorts to make comparisons between the markets. The market analysis should analyze occupancy, average daily rate, market penetration, and waterpark usage figures. Information from the market area is analyzed to determine the influences which will impact the surrounding market area and the value of the subject property. Calculating the impact of the indoor waterpark is a significant component of the analysis, and one which makes the analysis more complex than for a stand alone hotel.

Information concerning the subject's ad valorem taxes, zoning information, sales history, governmental restrictions, environmental regulations and other factors which may affect the subject property should be collected. If the property is existing, management should be interviewed to understand the operation as it currently exists. Extensive data should be collected from the property including building plans, financial statements, market segmentation reports, usage figures, and other statistics to understand and report the historical performance of the property to allow the appraiser to properly make projections.

If the property is proposed, the appraiser should review the plans for the property and analyze the developer's budget. The appraiser should compare the proposed budget with actual operating results of other indoor waterpark properties in comparable locations with comparable sizes. Research should be conducted relevant to the valuation process, including gathering income, expense, capitalization rate, and discount rate data;

comparable improved sales; land sales; comparable development costs; and any other information pertinent to the valuation of the subject property.

The appraiser performs three approaches to value and reconciles them into the market value conclusion:

The Income Capitalization Approach: This approach analyzes the property's capacity to generate income (or other monetary benefit) and converts this capacity into an indication of market value. The approach is particularly suitable to hospitality properties and indoor waterpark resorts as their value is primarily based upon the cash flow which they generate. The discounted cash flow (DCF) analysis is most appropriate for this analysis as it is a market reflective method of estimating the present worth of anticipated income benefits. The appraiser should analyze the occupancy, average daily rate, and various revenue and expense categories in determining the projected net operating income and value for the property. The appraiser should analyze the various departments of an indoor waterpark resort including outside waterpark sales, arcade revenue, gift shop, restaurants, lounges, meeting space, telephone, and other departments. Expenses for each of these departments should be estimated based upon an analysis of historical results and results from comparable indoor waterpark facilities. The discount rate and terminal capitalization rate for the analysis should be estimated based upon the industry surveys for hospitality properties taking into account the unique risk and income characteristics of an indoor waterpark resort property.

The Sales Comparison Approach: This approach compares the property to other properties that have changed hands fairly recently, at known price levels. The approach is most meaningful when there is adequate market data involving comparable properties. Reliability of this approach varies directly with the quantity and quality of available market data. This approach is more difficult for indoor waterpark resort properties due to the shortage of actual sales of these types of properties. As of 2004, there have only been a few sales of indoor waterpark resorts. As of the writing of this article, there are additional listings of indoor waterpark resorts in the Wisconsin Dells which, after selling, will provide a better indication of value for these types of properties.

The Cost Approach: In this approach, the cost to replace the improvements is estimated. A deduction is made for any depreciation, and the result is combined with the estimated value of the underlying land. The approach is applicable particularly for a proposed development where development budgets and land cost are available.

Financing of Indoor Waterpark Resorts

The lender will utilize the appraisal as well as an analysis of construction costs in determining the prospective loan for the project. Indoor waterpark resorts have been financed through a variety of methods. They include the following:

- Traditional banks
- Investment bankers specializing in the hospitality industry

- Wealthy individuals
- Self financed through cash flow of other properties
- Governmental backed loans and grants

To obtain financing for an indoor waterpark resort, a developer needs 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 basis for these projections.

Indoor waterpark resorts have proven to be more difficult to finance than typical hotel properties. Part of the difficulty in financing an indoor waterpark resort stems from it being both a hotel and an amusement attraction.

- Hotels are more difficult to finance than other types of commercial property. Their income, which relies on daily variations in occupancy, is less stable and predictable than income for properties secured by long-term leases.
- The addition of an indoor waterpark to a hotel creates more of an entertainment destination, which some bankers perceive to be more risky. However, the success of many of the existing indoor waterpark resorts indicates that there is a strong demand for these types of entertainment theme properties.
- The number of indoor waterpark resorts which exist in the United States is quite small - less than 50 with indoor waterparks over 10,000 square feet. Therefore, lenders need an educational process to help them understand the dynamics of these properties.
- The development costs for an indoor waterpark resort are typically much higher than for many hotel properties with some properties costing between $150,000 and $250,000 per available room including the indoor waterpark. The indoor waterpark itself may cost from $200 to $500 per square foot of net indoor waterpark space.

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 documentation as to 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 in determining the market value. Together these documents provide the lender with solid information on which to base prudent financing decisions.

David J. Sangree, MAI, CPA, ISHC interviewed various lenders and investors concerning the financing of indoor waterpark resorts in August 2004. The following chart summarizes the results from our interviews.

Indoor Waterpark Resort Financing Survey	
Interest Rate (%)	6% to 8% Approximately 2% to 2.5% over the prime rate
Terms of Loan (Years)	3 to 10 years
Years Amortize	20 to 25 years
Debt Coverage Ratio	1.5 to 1.7
Loan to Value (%)	65% to 70%
Source: US Realty Consultants, 216-221-9191, August 2004	

Typically, lenders require a higher equity contribution than would be applicable on a more traditional hotel loan. Our interviews with hotel lenders indicated that they are beginning to look with increased interest at indoor waterpark properties as compared to 2003, when there was limited interest. However, at this time, there still are relatively few lending institutions actively soliciting these types of projects. As hotels are already a more difficult type of real estate to finance compared to other commercial properties, the indoor waterpark resort is currently very difficult to find financing for. As more properties are developed and have shown strong performance, we anticipate that financing will become somewhat easier. In addition, the planned IPO by the Great Lakes Companies will increase Wall Street's knowledge of this specialized area of the hospitality industry.

Conclusion: The financing environment for indoor waterpark resorts is currently difficult with few lenders interested in this product type, and lenders requiring larger equity contributions. A new project requires well-documented market feasibility study and appraisal reports which fully explain the market dynamics and income potential for the resort project.

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