

## **Doing the Right Thing**

### **Budgeting for Survival**

About 20 years ago, the idea of getting into the “fun business” was pretty straightforward. The concept of course, was to locate a site, acquire some key attractions, and let the merits of the business sell themselves. While the general principles remain the same today, the way that we get there has changed dramatically. For starters, the costs of entering the industry have increased exponentially, with raw development costs often exceeding \$200/foot. This high price of entry leaves little room for error and demands that every dollar be spent with an extra degree of care and responsibility.

### **When Development Budgets Fail**

If there's one thing I've learned about the development of entertainment venues, it's that the budget is truly a moving target. The official budget is never really known until the last coat of paint dries and the site is deemed operational. What might have looked good on paper two years ago can prove to be severely upside-down when executed in present day dollars. Rising real estate prices, changes in market rents, escalating construction costs, and weaknesses in local economies can all contribute to cost overruns. When a project gets into trouble before completion, both the lenders and investors often lose, as there is generally no marketable product to sell, and often no capital remaining to access.

Recently my firm has been assisting a regional bank with a failed entertainment center project. The project, which was originally budgeted to cost \$5. million to build, has swelled to \$75 million and is only 85 percent complete. The principals have exhausted their own equity funds and the lender is reluctant to furnish additional capital for completion. The main culprit appears to be the under-budgeting of construction and site improvement work, as the original development estimates had been prepared nearly two years earlier. In this case, neither the lender nor the developer had anticipated significant changes in local pricing, nor had the developers re-confirmed their line item budget prior to construction. In essence, negative changes in the budget were allowed to mushroom uncontrollably without a clear understanding of how such overruns would be funded down the road. Finally, with all bank-issued construction funds extended, development at the site came to an abrupt halt.

### **Tips on Budgeting**

When it's time to establish a project budget, one of the first steps should be the creation of a protect timeline. The timeline serves as a benchmark for gauging changes in economic costs, particularly for projects whose development length extends more than twelve months beyond the budget's creation. A “timeline budget” is intended to accept cost changes resulting from general economic factors, including adjustments to the consumer price index (CPI), changes in interest rates, and appreciation of real estate. Quotations for the purchase of attractions, ancillary equipment, and general supplies should be updated every six months, with confirmations obtained in writing from the appropriate manufacturers or distributors. Time is the enemy for every protect, as changes in raw materials and energy prices often affect the price of just about every other item purchased.

I often hear the phrase “budget high” when chatting with new developers attending industry seminars. While the philosophy of doing so would appear sound, a high or inaccurate budget may paint the wrong performance picture for potential lenders. Instead, an ideal goal would be to establish a “verifiable” budget - essentially a budget with backup. All future purchases would be hard quoted, with the quotes serving as an addendum to the actual budget. Now, lenders and developers alike can find comfort in the budget process by reducing the number of unknowns, and more importantly, the number of cost overruns that can occur along the way.

### **To Bond or Not To Bond?**

If you intended to build a structure to house your new entertainment project, chances are that you'll need a qualified general contractor to coordinate the details. In the construction business cost is secondary to follow-through, as a half-completed project is infinitely worse than the premium price often associated with a reputable contractor. When a project fails due to poor contractor execution, there are often other consequences to the developer including significant time delays, additional interest carrying cost, unacceptable jobsite work that requires remediation, timing and availability of a qualified replacement contractor, and increased costs to complete the project. That's a lot of variables to juggle, particularly when time is working against you.

One alternative is to insist upon the use of a bondable contractor, recognizing of course that you'll be responsible for the added bonding fee. While the bonding process will add cost and possibly limit the supply of contractors deemed suitable for the project, it will provide a significant level of security to the developer, as contracted costs will remain tied whether or not the initial contractor completes the job. Bonding the project may prove to be a requirement of your lender as well, as few bankers wish to find themselves with a half-completed project and a non-performing loan,

### **Two Sets of Eyes Are Better Than One**

Creating an entertainment venue budget can be a daunting affair. My firm routinely reviews budgets prepared by new developers, and commonly observe omissions and assumptions that might not prove true in the long run. Most budgets

fail to adequately account for financing origination costs, early stage payroll, pre-opening expenses (utilities, real estate laws, water and sewer charges, engineering and for architectural fees), and legal services. When costs such as these have not been appropriately allocated in the early stages, the result is often a shortage of the most critical element — advertising dollars - at the most critical time. Advertising and promotion might be the easiest budgeted line item to pull funds from, but will often prove the most dangerous to the future business enterprise.

As a matter of course, have your budget reviewed by a number of parties, including your accountant, industry professional, and even an experienced entertainment developer. By doing so, you'll be better able to access the strong and weak areas of your plan long before entering the point of no return. Better still, your financial package will stand up to the scrutiny of bankers and investors alike and provide you with a greater sense of confidence as you enter each phase of development. You only have one opportunity to do it right; what better place to start than with a budget that works.