How to Package a Financing Request that will Attract Equity Investment

By James Conlow

Financing is about one thing: Profitable Exit for the Financier.

The financing request must satisfy a single basic requirement:

1. **It must provide verified proof of profitable exit for the financier.**

This profitable exit is proven by a combination of two items:

1. **A clear and verified path to profitability for the financier.**
2. **Verification of Value.** This includes future value if the project is successful and salvage value if the project fails. Financiers use the aphorism of "expect success, but plan for failure." With this in mind we must remember that an appraisal based on best future use does not show salvage value.

A financier has three basic questions: "What's in it for me?" "How do I make 100% sure that I will be successful?" and "How do I salvage my investment if there is a disaster?"

Additionally the people at the financial institution have a basic personal requirement: "If things go wrong and I'm called on the carpet by my boss, my investors, auditors, or governmental agencies, I need a file full of evidence to show why I made the decision to finance what now looks like a train wreck."

Every element of the package must be in writing: Verbal presentations simply don't fit in the file and the verbal presentation will not be available in a few years when the financier's executives are called on the carpet. Additionally the committee that gives final financing approval will never see the developer's verbal presentation. The entire request must be in writing and it must be able to stand on its own. Additionally not all members of this committee are expert in what they need to know and we must bend over backwards to give them a warm fuzzy feeling.

As a project developer you cannot truly comprehend the mindset of a financier. Not only is the financial world an alien environment, but financiers are different from each other. Don't bother with anger or frustration because it won't help. Do you think I'm wrong about this and that you have it wired? Most of us have trouble understanding the mindset of our children and spouse.

Here are some things to consider:

1. We must present an opportunity that is attractive to the financier.

1. It needs to be the right type of project. It needs to fit the needs and criteria of the financier.
2. It needs attractive risk adjusted returns.

At issue here is "What should a financier invest in and how much should a financier earn from an investment that is perceived as risky?" Today's financiers can invest with hedge funds and private equity funds that consistently earn very high returns (often over 30%) and that are exceptional at mitigating risk. Receiving standard financing is very difficult in 2008. This includes land loans and construction loans. You need a better package this year than last year for several reasons: Banks are not as liquid as they were. Too many development deals have gone south. Many appraisals have been found to not be factual. Once burned, twice shy. The world has changed. We are in a credit crunch.

Financiers are not in the charity business. This should be obvious but we see packages everyday that assume the financiers are impressed by the good that a project will do for the world rather than the good the project will do for the financier. Sure financiers like to finance projects that are good for the world – but the first requirement is maximization of profitability for the financier.

2. We need to show a clear path to profitability for the financier; a verified path that the financier can easily understand.

First we need to show in no uncertain terms how the financier will be paid back with an attractive ROI. At root this means we must show why the “market” will come and buy the finished product at a profitable price, and we must show that the development team has the ability to complete and sell the project. We need to show that we understand all of the risks (market risks as well as execution risks) and that we have an executable strategy to complete the project with particular emphasis on “pay-off” of the financier <u>with all risks considered and mitigated</u>.

This “plan” must be written because the financier needs to fill the file with the reasons he or she made the decision to fund. Verbal presentations are not relevant. Opinions about how great the project is are not relevant unless clearly presented in writing. We need multiple verified documents from believable parties.

3. For Interim Financings, we need verification that another financier will pay off the current financier.

This pay off is the exit strategy for interim financings.

4, We need to show underlying salvage value.

The package needs to show verified salvage value. Today an appraisal is required, but it’s not sufficient. We need more documents than ever before to satisfy this requirement.

The financing Request Package answers these questions:

Question 1: *If you build it will they come?* This is the market question. The only way to answer this question in a way that satisfies the financier is with believable market studies performed by third party professionals.

Question 2: *If they come will they spend enough money* to make this a profitable project that satisfies the hunger of the financier? This is a continuation of question 1: you need market studies.

Question 3: Can the team market and sell the product? You can hire this talent onto the team.

Question 4: Can the team design and complete the project for the price? You must provide a detailed, positive, believable complete answer to this question. But notice that this is question #4. The first 3 questions, *the market questions*, are of primary importance.

Underwriting is mostly about finding something wrong so that the project can be rejected. The job of the financing request package is to make sure that *first* the financier loves the project (because of its return) and *second* to make sure the jerk in the back office (me) can’t find a reason to reject it. You will rarely meet the persons that make the financing decisions, therefore the package must tell the story.

Standard Package for Development Financing

A financier needs many questions answered in order to ascertain: What is the opportunity? What are the risks? What does it take for us to engage and drive this through to success?

A financier needs to see the following items included in the package to assess the viability of a project:

1. **One page Investment Summary:** A one-paragraph executive summary (a simple description you would use to tell your grandmother about the project) together with a spreadsheet showing the opportunity.
    a. Half page written description
    b. Half page of numbers
2. **A two page Executive Summary** (a standard professional executive summary or brief).
3. **The Request:** Term sheet or proposal for moving forward. This includes your request and the financier's payoff. (You would be surprised at how many packages we receive that fail to mention how much money is being requested and how it will produce a return to the financier).
4. **The Project Business Plan:** At core a business plan tells the reader how the project will make money. It describes all aspects and operations of the project from initiation through pay off of the financier. Include pro forma financials. Put in your rationale for decisions you have made with respect to land use and product mix. What is special about this project? Complete description of the project.
5. **Pre-Sales / Pre-Lease:** Provide real documentation. This helps confirm an exit strategy.
6. **Market Studies:** Believable market studies are core to the package. This shows the feasibility of paying off the financier.
7. **Marketing Plan** for the Project: Provide a market study including regional populations, demographics, competitive projects, and how buyers in this region make buying decisions. How do you intend to handle sales for the project?
    a. **Who will buy?**
    b. **Why will they buy?**
    c. **When will they buy?**
    d. **How much will they pay?**
    e. **Why will they buy from your project rather than another?**
    f. **Does this project fill a real need?**
    g. **What is the competition?**
8. **History and analysis of the project to date.** Description of the property today and any changes since you became involved. Who are the players on all sides and what have they done? Include information about planning, government officials, and personnel from utility companies. Contact list.
9. **Project Description:** The documents you use to describe the project. Masterplan, elevations, floor plans, etc. Try to make this exciting.
10. **Any other documents that describe the project.** Drawings, photographs, maps…

11. **Project Ownership**, current and proposed. List every stock holder, every partner, every person that thinks they have any ownership connection. Who might come out of the woodwork?
12. **Current Debt Structure.** Provide a complete report. You will need a Title Report and copies of all current notes, etc.
13. **Company/Project Ownership** and structure. List every large stock holder, every partner, every person that thinks they have any ownership connection. **Financiers will need financial reports for every person with substantial ownership in the project.**
14. **The Team.** Describe your team and provide resumes of all relevant players. Describe the whole team including your independent contractors such as designers, marketing companies, builders, real estate brokers, consultants, etc. This is your team and you can take advantage of all their past success and experience.
15. **Valuation.** Provide Pro Forma Assessment of value today and the value at each projected milestone. What is your estimate of the future market value of each product type and how have you determined this value? Provide market studies to back up your estimates.
16. **Appraisals:** Provide current appraisal by trusted third party. The financier may need its own appraisal too. *A word about appraisals: At least one appraisal is required and often financiers need more than one. But an appraisal is not sufficient in today's environment. A financier needs other proof of value. This is because most financiers have suffered loss because they believed an appraisal that over-valued a project.*
17. **Financials (Actual and Pro Forma):** Provide industry standard estimates of all development and construction costs required to achieve each milestone (to be believable these estimates must be by a trusted third party like a known general contractor). Include other costs such as marketing, facilities care, operations cost and maintenance, Taxes, etc. Source and use of funds. Forecast of cash requirements during execution (tied to schedule).
    a. Financiers need to see how much skin you have in the game. How much have you and others actually spent to date? Please provide your accounting including a complete breakdown and even receipts for major expenses. Include sweat equity, as appropriate.
    b. How much is owed to others? List all actual and potential debts. Have you made any promises to anyone? Include sweat equity, if appropriate.
    c. For Income Property: You need pro formas showing the operations for each operating category, showing all revenue and expenses resulting in the net operating income each year after construction completion for 5 to 10 years.
    d. Source and use of funds
        i. Historical, to date.
        ii. Planned: What are you going to do with the money from this financing?
18. **Schedule:** Provide a schedule of your plans, including milestones, with respect to the development process and the construction process. What does it take in a step by step process to get from point A to point Z with respect to time, professional resources, approvals, and money? How can we speed this up? What are the potential roadblocks? (Point Z is when the investor gets his return and is no longer at risk).

19. **Current Conditions with respect to Schedule.** Description of current condition of the development process. Provide Environmental Reports, Title Reports, Entitlements.
20. **Entitlements:** Description and analysis of current condition with respect to planning, approvals, zoning, easements, maps, and permits. Every municipal jurisdiction has some differences so provide a complete description of what the zoning means. (for example, I have no idea what CD2-7 means). Pretend you are describing this to a person that does not understand entitlements (because you are – there will be people on the loan approval committee that do not understand and need to be educated). What specific approvals are required, what agencies are involved, and what are the target dates?
21. **Other Agreements:** What is the condition of all agreements with governmental authorities and utility companies? What specific problems are you facing? What are the future problems? What future agreements are required? Is there any bad blood?
22. **Description of problems** in the process (include solved problems, current issues, and items that you think are upcoming). List your solutions.
23. **Infrastructure:** Description and analysis of sitework, utilities and common infrastructure. What is currently supplied and how, by what entity, what needs to be added, include estimated costs and schedules, include proposals from contractors.
24. **Environmental Reports** and mitigation plans for any issues.
25. **Problems:** List and describe any safety issues, hazardous materials, environmental problems, and other risks. Who is responsible? List all remediation plans and proposed remediation plans. Show that you understand the risks and that you have a realistic plan.
26. **Risks** and how you plan to mitigate.
27. **Profitable Exit for the Financier.** Spell it out.
28. Tell me why a I should trust you with my hard earned money. Many good projects fail. Collateral is not enough. Financiers do not want to foreclose on you. They want all of their investments to perform in accordance to the plan.

The above list is too much for some projects and not enough for others. Every project is unique and you need to include all relevant information to convince the financier that he/she should make a decision to provide you with funds.

The many catch 22's …

No matter how complete a developer thinks the package is, the financier will ask for more documents. It is of no use to become frustrated by this. Financiers use the presented package to develop next steps and questions. On the other hand a financier will not bother to look at an incomplete package. They simply have too many "complete" packages to analyze… So you must create and submit a complete package knowing that the financier will find something deficient.

Many developers want a financier to present a term sheet on a "incomplete package" with a list of deficiencies. While this seems reasonable in the development world it is considered unreasonable in the financier's world. There is no profit in trying to get a financier to move outside of his/her comfort range. Just submit a complete package.

Checklist for Financing Package:

1.	**One page Summary**		
2.	**A two page Executive Summary**		
3.	**The Request**		
4.	**The Project Business Plan**		
5.	**Pre-Sales / Pre-Lease**		
6.	**Market Studies**		
7.	**Marketing Plan**		
8.	**History and analysis of the project to date**		
9.	**Project Description**		
10.	**Other descriptive documents**		
11.	**Project Ownership**		
12.	**Current Debt Structure**		
13.	**Company/Project Ownership**		
14.	**The Team**		
15.	**Valuation**		
16.	**Appraisals**		
17.	**Financials (Actual and Pro Forma)**		
18.	**Schedule**		
19.	**Current Schedule Conditions**		
20.	**Entitlements**		
21.	**Other Agreements**		
22.	**Description of problems**		
23.	**Infrastructure**		
24.	**Environmental Reports**		
25.	**Problems**		
26.	**Risks**		
27.	**Profitable Exit for the Financier**		