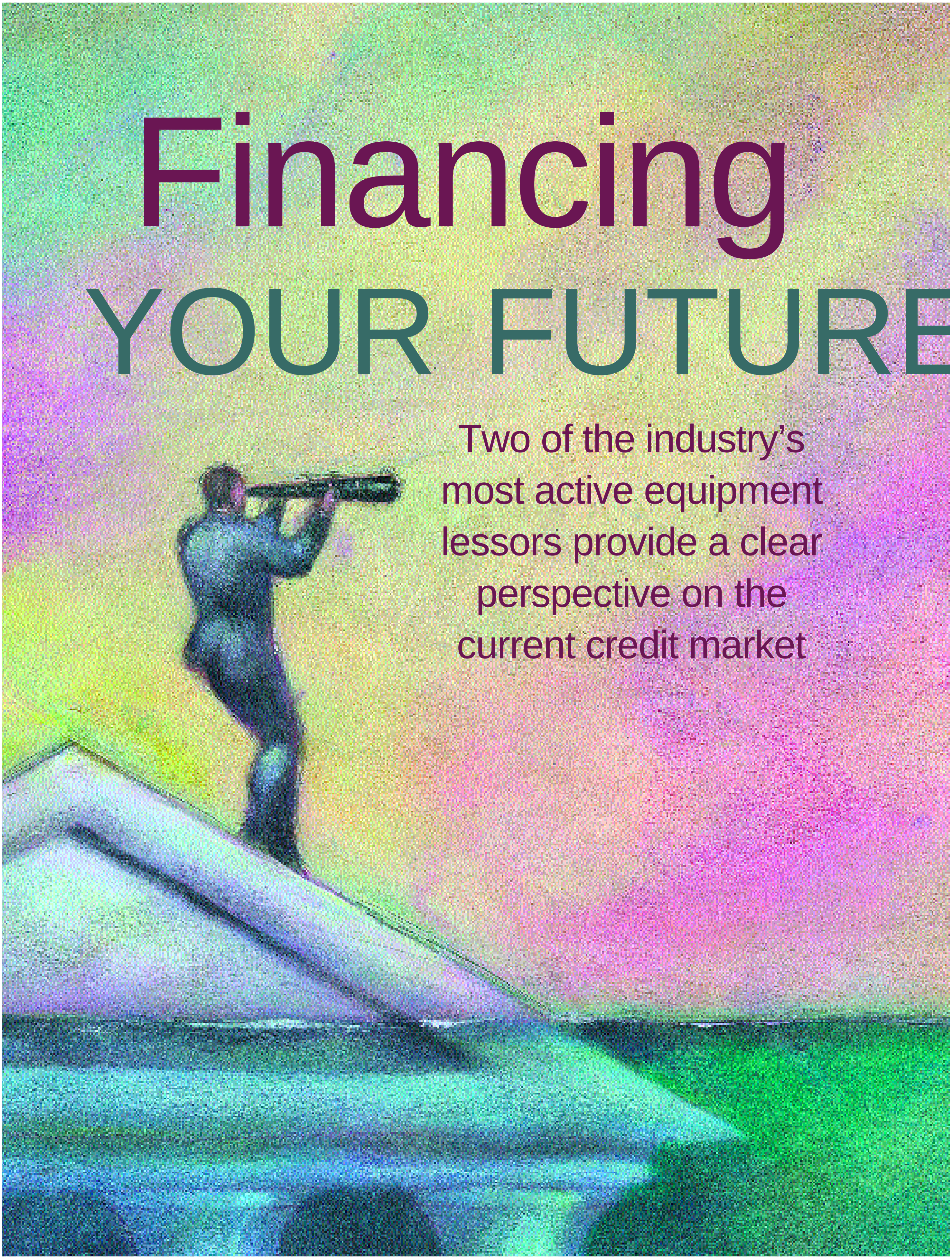
Financing YOUR FUTURE

Two of the industry's most active equipment lessors provide a clear perspective on the current credit market



By Craig R. Waters

Each year, health clubs, Ys, and a wide variety of fitness and healthcare centers purchase some $700 million of fitness equipment in the U.S., and lease an estimated 70%-75% of those acquisitions. As a result, leasing represents a major source of capital for the health and fitness club industry, and, like other capital sources—e.g., banks, venture capital companies, the public markets—has recently been affected by a slowing economy. To find out what implications that has for club developers and operators, *CBI* grilled two of the industry's foremost leasing authorities: Daniel W. West, the president and CEO of the Macrolease International Corporation; and Joe Schmidt, the president of F.I.T. Leasing.

CBI: Give us a sense of what's happened in the credit markets recently.

West: There's a general sense, in the leasing and banking industries, that the fitness industry—even though it may be recession-resilient—is going to parallel the general curve of the economy, and that, as unemployment increases, there's a reasonably good chance that memberships are going to drop off. The biggest challenge for a customer seeking financing today is a feeling that, in this economy, fitness is a vulnerable industry. As a result, all lenders are being more conservative in terms of risk.

Schmidt: You also need to understand that, for a variety of reasons, the leasing industry hit tough economic times about a year before the rest of the country, starting in early 2000. Before that, lease companies had access to lots of capital. But when the capital dried up, and when, like Enron, some of them restated their earnings and revealed that they were losing money, killing Wall Street's interest, a number of these firms—many of them wholesale lenders who financed other lease companies—went bankrupt. FINOVAGroup, Inc., UniCapital Corporation, BankVest Capital Corp.—the list was long. So, over the last two years, access to easy capital absolutely dried up; and at the same time, delinquencies skyrocketed. So what's happened is, the funding sources that are left have tightened their credit window dramatically.

CBI: If there are fewer lease companies serving clubs, and they're applying more stringent standards, what does that mean in terms of how you evaluate a lease application today?

West: We're more diligent about doing our homework. We're scrutinizing everything much more carefully.

We want to know more about the background, the quality, of the people that we're working with; how sound their business is; whether they have adequate capital to operate and to deal with unexpected emergencies. The lease companies, as well as the banks, want to make sure that they don't become a club's source of working capital—where, when the club can't make a payment on time, they come back and say, 'Gee, we need an extension… or a rewrite.'

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Schmidt: We're doing a lot more due diligence today. In the past, if a customer provided us with a financial statement that said they had $100,000 in stocks, we'd say, 'Fine', but, now, we'll ask for a recent account statement. If an applicant says they've got $50,000 in the bank, we're probably going to ask for a bank statement too. Before, we might fudge on the terms for a lease. For example, the standards might be that they had to have been in business for three or more years; have an average bank balance of $10,000; and have comparable credit, from another lease or loan, equal to 50%-70% of the amount they were seeking. Two years ago, we might have relaxed those criteria, accepting something less in terms of longevity, bank balance, or comp credit. Today, it's rare to vary from policy.

CBI: So there's less flexibility now?

Macrolease-ers Al Rousseau, left, director of commercial sales, and Daniel W. West, president and CEO

Schmidt: Much less flexibility—that's probably the hallmark of the current financing environment.

CBI: How can a club developer or owner maximize their chance of obtaining the funds they're looking for?

West: My first piece of advice would be: the better the package, the more complete and accurate the presentation—the easier it is to sell. My second bit of advice would be: if, after an arrangement has been fashioned, a club owner gets into any sort of trouble—e.g., because of the economy, or a natural disaster—the first thing they should do is let their lease company know that they're going to be facing a challenge for a given period of time. That type of client always gets my attention. It's more difficult to finance a startup. There,

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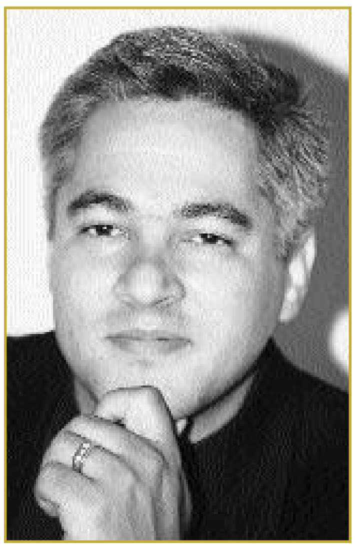
Joe Schmidt is the president of F.I.T. Leasing, based in Tustin, California. Founded in 1983, the firm has focused on the fitness industry since 1990, and has arranged more than $25 million in financing for some 2,000-3,000 clubs; its current portfolio encompasses 600 facilities, representing $8 million in leases. F.I.T. specializes in "small-ticket" transactions, averaging about $50,000, but can accommodate requests for more than $500,000. Its client list includes commercial health clubs (85%), corporate fitness centers (15%), and "an occasional" YMCA.

Daniel W. West is the president and CEO of the Macrolease International Corporation, of Plainview, New York. Founded in 1969, the company concentrates on the fitness and leisure industries, and has arranged more than 6,000 leases for a wide range of clients, including commercial clubs, corporations, hotels, spas, hospitals, healthcare clinics, wellness centers, schools and universities, YMCAs, JCCs, and park and recreation departments. Approximately 35%-40% of the company's financing activity involves startup facilities, and the remainder is with existing businesses. West is a founding member and past president of the Eastern Association of Equipment Lessors.

the most important things we look for are the experience of the developer; the quality of their due diligence and business plan; their banking facility; and the level of their investment in the business—there has to be a serious buy-in on their part. But even a qualified developer should plan on making a rather substantial down payment on their equipment—as high as 50%.

Schmidt: It's easier if their business and personal credit are both clean. We often receive applications from people, and, when we run their personal credit, we find open judgements, collection accounts, tax liens—those sorts of things make it much harder. Also: when people provide financial information, it should obviously be accurate. Someone will say they make $100,000 a year, and when we request their tax returns, the returns show $18,000. "Well, we don't tell the government everything," they say. Well, that explanation's not going to fly.



F.I.T. Leasing's Joe Schmidt

CBI: Given the tightened credit market, what's happened to interest rates?

West: The rate matrix that's in place right now is very unusual, and I don't think we've seen a similar situation in the past. The prime rate and bank discount rates are very low, but interest rates in the fitness industry, and most other industries, are higher than one might expect. I mean, today, the discount rate is 1.75%, and mortgage rates are increasing. I think that matrix is going to remain in place for awhile. Today, on a small transaction—say, a $4,000 treadmill—a club owner is probably going to pay in the high-teens (e.g., 16%). On a large transaction, in the $500,000 range, involving high-quality credit, and structured as a dollar-buyout lease, they may pay 6%-7%; and, if the same transaction were to be structured as a "true" or "fair-market" lease, they might actually pay less than 0% in credit. In general, lease rates in the fitness industry parallel those in banking.

CBI: What sort of advice would you offer to club owners when shopping for a lease company?

West: You have to do the necessary homework. Talk to your equipment vendors, and find out what they know about the firm. Take the proposal to your bank or another lease company and ask them to evaluate it. The smoke-and-mirrors can materialize in a number of ways: Acompany can ask for a large down payment, which they call a security deposit, then finance 100% of the equipment, and hold onto the deposit to be used as a purchase option payment at the end of the lease; so you wind up making monthly payments that may seem low, but, given the unreasonable purchase option, the actual interest rate is unconscionable. There are also, unfortunately, a number of lease companies that misquote rates, promising ones lower than those they deliver.

Ask the lease company where they're getting their money from and obtain references

Schmidt: Ask the lease company where they're getting their money from and obtain references—three from clubs that they've financed, and three from equipment manufacturers or dealers that they've worked with. Make sure that you completely understand all of the details of the lease—e.g., term of lease, sales tax treatment, advance payments, monthly payments, and end-of-lease terms—before you sign it.

CBI: What about the demand for equipment—how has that been affected by recent events?

West: I've noticed that the major operators are being very conservative in terms of their acquisitions today; my sense is that there's some pent-up demand there. We're very busy, however, financing the smaller operators.

Schmidt: Equipment purchases and financing tailed off very sharply during the first half of 2001. One reason was that existing clubs were buying less, but, more importantly, the startup facilities, given the growing economic uncertainty, were postponing their purchasing decisions. We started to see more applications, more new business, at the end of the summer, in August. September, October—nothing happened; everything dried up. Then, at the end of October, and in November and December, we saw a huge increase—maybe more than in any other year. Things normally get busy, in terms of equipment sales, in the last quarter, but, this time, it was exceptional. I've worked harder in the last 60 days than I have in the last five years. ■

CRAIG R. WATERS is the editor-in-chief of CBI.