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- On-the-Lane Tech Offers Memorable Experiences
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- Resolve to Keep a Few Marketing Resolutions

BOWLING PROPRIETORS' ASSOCIATION OF AMERICA
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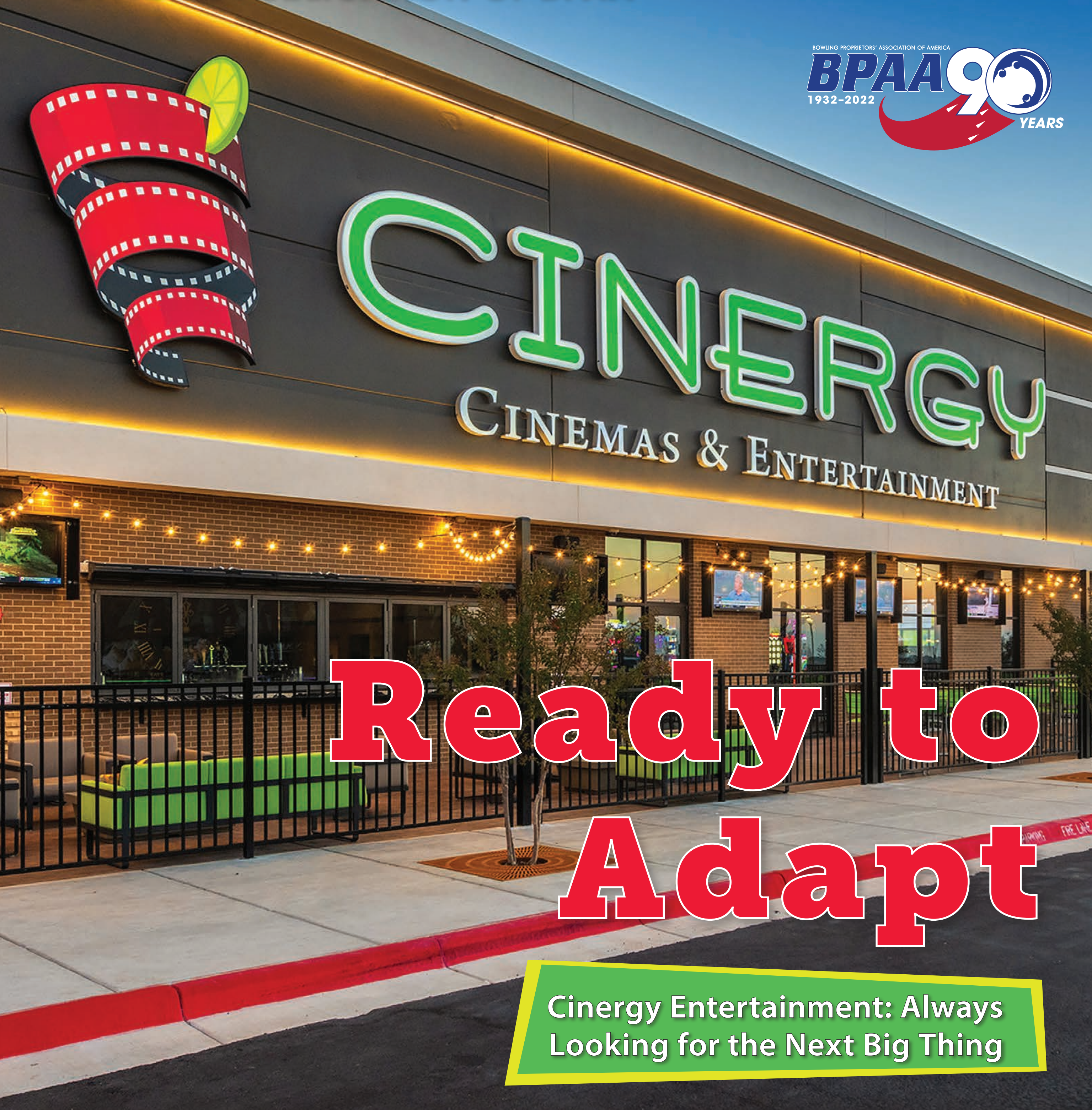

Ready to Adapt

Cinergy Entertainment: Always Looking for the Next Big Thing

The Argument for VARIABLE RATE LOANS

While not for everybody, they can help some proprietors take the next step in growing and strengthening their business.

BY KEN PATON

Long-term fixed rate loans are the gold standard of financing. But not every borrower will qualify for one and not every lender will offer them. So, the question becomes: When is the risk of a variable rate loan acceptable?

Each loan presents a series of risks to the lender:

- Can and will the borrower pay as agreed?
- What risks does the borrower's industry present?
- What is the borrower's local economy like?
- What is the national economy like?
- Does the lender understand the borrower's business and industry?
- What is the collateral, and can it be liquidated if necessary?
- What is the value of the collateral in liquidation?

These and many additional considerations make up the lender's decision matrix.

For example, most lenders are willing to make a fixed rate loan to a borrower with a good credit rating, demonstrated experience in business, good historic cash flow, and an office building, warehouse or other general purpose building as collateral. However, when the borrower's time in business is short or where the borrower has had cash flow problems, fixed rate loans are unlikely to be offered.

Also, very few lenders will make a long-term fixed rate loan on a special purpose building such as most bowling buildings without a very extensive track record and a low loan to value. The bank may accept the interest rate risk of a fixed rate loan but only if the other risks are within an acceptable range.

Although adjustable rate loans can present risks to borrowers, there are times when they can make sense. Most proprietors will use a variable rate loan to buy a bowling center if it is the only option that is available. If the profit potential is high enough and the center's cash flow is consistently strong, the risk may be acceptable.

Adding a low down payment or if the borrower has a less-than-perfect credit report to the equation often means a Small Business Administration backed loan. SBA 7(a) loans almost always have an adjustable rate of interest but offer a 25-year term with no balloon payments to help mitigate the risk of an adjustable rate, and are available with only 10% down on a purchase of a bowling center. They can also be used for

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expansion financing with no down payment in some circumstances.

League houses may find the adjustable rate an unacceptable risk because the linage fee can be increased only once per year. Even so, food and bar prices can be adjusted more frequently.

Adjustable interest rates tied to the prime rate normally move as a reaction to inflation. The Federal Reserve will push rates up to slow inflation and reduce them if the economy starts to slow down. Most people will understand that inflation affects all aspects of their lives, including the cost of bowling. As a result, raising prices during an inflationary environment will not come as a surprise to most bowlers.

However, few traditional centers generate more than 15% to 25% of their revenue from competitive leagues, with the balance coming from recreational leagues and open play. As a result, there are generally opportunities to raise prices more frequently than once per year.

Using an example, a bowling center with $800,000 outstanding on an adjustable rate loan with an interest rate of 6% and 20 years remaining gets a notice that the interest rate will rise to 7%. The payment will rise from $5,731.45 to $6,202.39, or by $470.94 per month. Assuming the center generates $1 million in annual revenue, the proprietor will need to raise prices by one-half of 1% to cover the additional interest costs.

If this is a league house where 100% of the linage is fixed for the year but the food and bar revenue generate 30% of the gross revenue, increasing food and bar prices less than 2% will cover the increased payment.

If the center generated $500,000 in annual revenue, the required price increase on food and bar items would be 1.1%. Since the prime rate generally moves in one-quarter increments, most proprietors should find this risk to be acceptable.

The risk of buying a center with an adjustable rate loan depends on the upside potential. Mike and Jeny White, along with investors, purchased Belt Bowl in Saint Joseph, Mo., which had employed them for the prior eight years. At the time of the sale, the center relied primarily on league bowling and its bar for its revenue.

The Whites used an SBA loan to purchase the business and real estate, and began converting to a family entertainment center. New scoring was added along with laser tag and an arcade. New flooring was installed, the building was painted and deferred maintenance was corrected.

Bar prices were raised to discourage the heavy drinkers, and birthday party packages were developed and presented to the community. After three years, including part of 2020 following the pandemic-mandated shutdown, revenue was up 10.5% with a shift from league bowling to open play and an overall 4.5% increase in bowling revenue. Food and bar revenue was down, but the arcade and laser tag generated more revenue than was lost. Expenses were down, with an increase in net operating cash flow of 750%.

Once the renovations are completed, the Whites expect to be able to refinance to a fixed-rate loan.

Another successful purchase was Pioneer Lanes (now Plainfield Lanes). It was bank owned following the bankruptcy and foreclosure of the center when Jon Dow and his brother purchased it. At the time of the sale, it was generating less than $750,000 in revenue and $100,000 in net operating cash flow compared to more than $1.5 million in revenue and $450,000 in net operating cash flow after five years.

The changes that Jon financed with a variable rate SBA loan, coupled with his management skill, turned a business failure into a success and easily mitigated the adjustable interest rate. Within three years of the purchase, a local bank stepped in to refinance the adjustable rate loan into a fixed. Jon felt that the upside potential was worth the interest rate risk and the results proved him right.

The loan term can influence risk more than a rate adjustment. A $300,000 scoring system financed with a typical equipment lease will have monthly payments of more than $6,000 with an effective interest rate of 9% and a five-year term, while an SBA 7(a) loan will have a payment of $3,300 with an interest rate of 6% and a 10-year term. The rate on the SBA loan would have to rise to more than 17% before the payments became equal.

Paying off the equipment sooner results in lower total interest costs, but there also is an advantage to having lower payments during the term of the loan if the center gets into financial trouble.

Proprietors who are old enough to have been in business in the late to early 1980s will remember prime shooting up to more than 21%. Although this could happen again, the high inflation of the 1970s created a unique environment. Over the past 20 years, inflation averaged less than 4%, with the last 10 years under 2%. During this time, the prime rate has dropped from a high of 9.5% in 2000 to 3.25% today.

The prime rate is tied to the Federal Reserve policies, so it can be hard to predict. While the economy coming out of the pandemic-created recession seemed comparable to the high inflation of the 1970s, the Fed appears to be less concerned about inflation than it was then and therefore is less likely to push up interest rates — at least as of early December.

> The Federal Reserve appears to be less concerned about inflation than it was during the 1970s and therefore is less likely to push up interest rates — at least for now.

Other than during the period between 1965 and 1980, the prime rate has been flat or trending down. Most historians look at the Vietnam War as the primary cause for the inflation that pushed up the prime rate. The long involvement in Afghanistan and Iraq did not generate similar inflation, but there is a risk of COVID-19 turning into a negative influence on inflation. Therefore, the decision on adjustable rate loans may not be as simple as looking at the trend over the past 10 or 20 years.

Adjustable rate loans are not for everyone, but ownership of a bowling center also is not for everyone. Proprietors with good management skills, the right situation and a little luck will not only survive but prosper. Many others will survive and make a good living. A detailed analysis of the risks and potential rewards should allow a good decision for each individual situation.

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