

European Film Production Banking Schemes



Neighbouring Banks
Meet Film Producers

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Neighbouring Banks Meet Producers

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Overview

In the recent years a decline in bank loans to the audiovisual sector was noticeable due to the so-called Internet bubble, which burst in the year 2000 after half a decade of overblown virtual businesses, relatively modest returns on loans in comparison with the investments in the audiovisual sector, the reputation of this sector as risky, new banking regulatory constraints associated with the implementation of international agreement Basel II¹, and the changed macroeconomic situation, which forced the banks into well-trying and safer investments². In the field of investments, the banks have

1 The international agreement of banks on the capital and risk control Basel II is a recommendation for the policy-making with regard to risk management, which basically sets out the amount of capital that the financial institutions must have at its disposal in view of the financial and operative risks they face. The preceding agreement, Basel I, was drawn up in 1988, while Basel II was drawn up in 2004 (adopted in 2006; in the European Union it entered into force on 1 January 2007 with the *Capital Requirements Directive – CRD* of the European Commission). Basel II is based on three pillars: *minimal capital requirements, supervisory review and market discipline*. The agreement was prepared by the *Basel Committee on Banking Supervision*, founded in 1974 by the governors of the central banks of the ten most developed countries, gathered in the G-10 group (FSA, website)

2 Deleau in Lange et al, 2004, 8

become apprehensive because of the current global economic crisis, which affected the film sector adversely. Namely, the investors are now much more careful in their decisions to invest in high-risk sectors, especially the film sector, which has always suffered from structural fragility and financial deficiency due to its very specific nature – a high risk from the viewpoint of the investors, who entrust small or medium-size companies with little resources of their own with relatively abundant financial resources. The passive role of banks in the film sector was also confirmed by the research *Study on the Role of Banks in the European Film Industry* (2009), commissioned by the European Commission – MEDIA Programme.

Possibilities for Bank Financing in the European Countries

The inclusion of banks in the financing of films is still a boutique business, since it calls for a high level of expertise in a restricted film market, where the returns in the majority of the European countries are much more modest than the appetites of the banks³.

3 Baujard 2009, 15

From a lending bank`s viewpoint the financing of films is similar to project financing, not the financing of companies, since the repayment of the loan depends on the success of the producers and their ability to complete the film within the foreseen budget and ensure enough income to cover the debt. Therefore it is the practice of the European banks to back the film producers with minimum guarantees during the sales of the film to the distributor at the development (pre-sale) stage and during the conclusion of contracts with television stations⁴. As detailed in the more recent research on the role of banks in film financing, *Study on the Role of Banks in the European Film Industry*⁵, the bank financing takes place in five forms altogether:

1. Gap financing is the bridging of gaps in the financing of the production on the basis of a detailed analysis of the potential sale of distribution rights or other rights.

Usually this form of financing amounts to 15 to 20 % of the production budget⁶ and depends on the model of financing: the classic gap financing model covers 10 to 15 %, while the supergap financing model covers up to 30 % of the production budget. Due to the current economic crisis the latter is used extremely rarely.

4 Deleau in Lange et al, 2004, 9

5 Baujard et al, 2009, 14-15

6 Deleau in Lange et al, 2004, 9

Because of the high risk it is also one of the most expensive forms of financing, involving a huge amount of administration in order to prove the financial capability of the company, the project's potential, as well as numerous additional guarantees (completion bond, production insurances including errors & omissions, liability and/or indemnity for at least the director and main cast, third person guarantees, etc.). In Europe gap financing is provided, among others, by the Allied Irish Bank in Great Britain and the Commerzbank and NRW Bank in Germany⁷ while the Bavarian Bank Fund (Bayerischer Bankenfonds - BBF) provides this option in a public-private partnership. Namely, BBF was established in the year 2000 by four Bavarian financial institutions: Bayerische Landesbank (federal state-owned public bank), LfA Förderbank Bayern (regional development bank, owned by the federal State), HypoVereinsbank (retail bank, UniCredit Group member) and Bankhaus Reuschel & Co (private bank, part of the Commerzbank Group) with the initial funding of 10 million euros to create revolving fund. Until 2008 this Fund has provided about 23 million euros of loans for the production and distribution of feature films. The films must have the potential of being commercially successful and must be supported by the regional fund FilmFernsehFonds Bayern (FFF). The loan of up to a million euros for production or

7 Baujard et al, 2009, 49-51

up to 200 000 euros for distribution is approved by the bank LfA Förderbank Bayern, and it may amount up to 100 % of the issued FFF funding for the project⁸.

2. Interim financing (also provisional financing) or contract discounting is a loan, ensuring a smooth cash flow for the producers after the signature of all financial agreements with the other partners – for example, tax-incentive deals, distribution contracts or minimum guarantees from the sales agent, subsidy funding contracts, etc.

The payments in accordance with the majority of contracts take place in instalments and do not take place before the start of the production (before the first day of principal photography) or, in case of tax incentive and sales agents/distribution advances, even until after the film had been completed. Meanwhile expenditure on a production begins when pre-production starts and doesn't end until the copies of the film are delivered to the distributor. There are two models of interim financing: the classic contract discounting model and the revolving credit cashflow model, differing from each other in terms of sophistication: pursuant to the classic model the producers gets a loan, which they must repay within a certain deadline; while the revolving credit

8 Baujard et al, 2009, 70-71

allows for the credit lines on a film-by film basis, through which the producers may take and repay loans as needed. Among others, interim financing is provided by the Allied Irish Bank and Coutts & Co. in Great Britain, Natixis Coficiné, Cofiloisirs and Fortis Mediacom Finance in France, and ILB - Investitionsbank des Landes Brandenburg, Commerzbank, Hypovereinsbank and NRW Bank in Germany⁹.

3. Tax incentives financing has been on a swift rise with the amended tax incentives scheme. For many banks it represents the basic source of financing in the field of film industry today, as the loans on the basis of tax incentives are relatively safe investments.

The tax incentives financing is provided by nine banks in five European countries through well-established schemes: ING/TS Productions in Belgium, Raiffeisenbank/RC Consulting in Hungary, Natixis Coficiné, Cofiloisirs and Fortis in France, Allied Irish Bank, Barclays Bank and Coutts & Co. in Great Britain, and Anglo Irish Bank in Ireland. The banks provide several models of tax incentives financing, depending on the type of tax. The tax credit cashflowing model is the financing of the cash flow with a tax credit, which sometimes entails even above 20 % of the

9 Baujard et al, 2009, 41-44

production budget and allows the producers to ensure the cash flow for the production, since in accordance with the tax credit model the state only reimburses the financial resources after the final settlement of the production. The tax-incentive gearing model is a form of financing where the banks combine their financing (loaned capital) with capital from third-party private investors (equity or risk capital) to create a more robust model of financing that meets the needs of all three parties: third party investors, film producers and creditors – the banks – themselves. This model attracts the investments by the private investors into film production, which allows the producers to take larger bank loans than they would receive through the tax incentive itself. It is used in case of a tax shelter, sometimes in combination with tax credit providing the investment guarantee¹⁰.

4. The **working capital/corporate financing** is approved by the banks to companies in view of the balance sheets of the last two to three years and their accumulated assets, while the banks are only interested in the companies with the annual turnover of at least EUR 10 million.

Since on average many small and medium-sized production companies only produce a single film every two years, the banks

are not interested in providing these kinds of loans to the film producers, therefore even in the biggest European countries with well-developed film markets only a few qualify (for example, two or three in Germany, and one or two in Great Britain). However, this type of financing may be considered in case of television producers, who maintain a long-term relationship with the television programme broadcasters, as well as in case of agents and distributors. The European banks also often provide this type of financing to the American studios. There are two models of the established financing of working capital/corporate financing: for producers (mid-cap credit facility model) and distributors/sales agents (asset-backed lending model). The first model is intended for producers or film studios which qualify with the company assets and annual turnover as well as with the regular annual production of international projects from the so-called A-list. The loans provided to the studios are, for example, intended for the production and marketing expenses for a new group of cinematographic projects. In the second model the company proves its assets in the form of a steady flow of exploitation rights on their balance sheets over the course of several years, therefore especially the sales agents, distributors and television producers qualify for this type of loans, and the loan is, for example in case of TV producers, intended for the production of a slate

already sold to the television broadcasters. The public-private loan model has also been tested, and perhaps it will become more frequent in the future. The public-private loan model was established in 2001 by the Anglo Irish Bank together with the Irish Film Board, when it provided five Irish production companies (four renowned and one newly established but managed by two highly experienced producers) with loans for the slate funding for development/production with an international potential, involving 10 to 15 films per company in the period of three years. In this period each of the companies would successfully finance two to three out of these 10 to 15 films, and the repayment of the loan would represent a part of the production budget. The Irish Film Board contributed 50 % of the loan, Anglo Irish Bank 30 %, and the producers had to invest the remaining 20 %. The bank approved loans to the producers with the right of seizing the copyrights for the whole slate in case of non-payment. Furthermore, the bank also had the right to withdraw its own investment as well as the investment of the Irish Film Board until its share of the loan was recouped. Thus in the following three years the producers could cover the general expenses with 25 % of the loan, while the remaining 75 % was invested into project development¹¹. A special example of the financing of small and

11 Baujard et al, 2009, 53-57

medium-size companies comes from Portugal, where the state through the development agency for small and medium-sized companies IAPMEI (Instituto de Apoio às Pequenas e Médias Empresas e à Inovação), in cooperation with the main television broadcasters (ZON Multimédia, SIC - Sociedade Independente de Comunicação, TVI – Televisão Independente and RTP – Radiotelevisão Portuguesa) established FICA, an investment fund for cinematographic and audiovisual works, with the initial capital of EUR 83 million. The loans are granted through the Banco Espírito Santo (BES) bank, founded to this end, as direct investments into the films from the development to the distribution stage in the amount of 60 to 80 % of the production budget, or as indirect investments into the companies, groups of companies or funds, promoting or investing in the cinematographic, audiovisual or multi-platform production in the amount of 20 to 40 % of the production budget. In case of direct financing, FICA claims a part of the copyrights *pari passu* up to its equity share in the budget, while in case of indirect financing it claims a capital share. FICA finances feature live-action or animated films, television documentaries, live-action, animated and documented TV series and TV films¹².

12 Baujard et al, 2009, 70-71

5. **Bank guarantees** represent the common service of the financial institutions, since the production companies use them to mitigate the risk involved, for example, when pre-selling the rights to television broadcasters (the broadcaster insures its investment in the film with a bank guarantee in case of undelivered films or unfinished productions), or when shooting international co-productions abroad (a foreign bank demands bank guarantees from the foreign producer's domestic bank in order to grant a loan to the foreign producer).

In certain European countries, public-private partnership institutions are also being established, providing similar guarantees in order to facilitate the acquisition of bank loans by the film producers, which is an additional aid to the banks in the effort to minimise their risk. Such institutions exist in France (IFCIC), Spain (Audiovisual SGR) and Germany (Landesbürgschaft). However, since 2006 the French IFCIC has also been available to non-French producers through the Coficiné, Cofiloisirs and Fortis Mediacom Finance banks, which supported six films in 2007 and eight films in 2008¹³.

The financing possibilities depend on the size of the territory, since most incentives are provided in the so-called “Big Five” – the five largest countries of the European Union (Italy, France, Great Britain, Germany and Spain), which are the only European countries to meet the conditions for the active approach of the banks towards the financing, which is made possible by their sufficiently large and developed markets. The second group of countries, consisting of Belgium, Hungary, Luxembourg and Ireland, allows especially for the tax incentives financing, while **Slovenia** belongs in the third and largest group of countries together with 23 other small countries, where the small size of the market precludes the provision of loans by the banks¹⁴.

Possibilities for Bank Financing at the European level

At the European level, film financing is assisted by the **European Investment Bank – EIB**, founded in 1958 as a bank of the European Union, owned by the members of the European Union. All EU states contribute to its capital, and the contributions of individual member states reflect their economic importance in the Union. It is a non-profit bank, providing long-term loans for

capital investments (especially fixed assets) to the public and private sector for the projects in the European interest. It operates in the European Union as well as in 140 countries around the world, which have concluded cooperation agreements with the EU. The bank does not acquire resources from the EU budget, since it is financed by providing loans at the financial markets. EIB encourages the film industry through four types of cooperation with the partner banks for the commercial co-financing of audiovisual projects:

- **Individual or corporate loans** are intended for projects entailing extensive investment costs, including especially radio and television stations (investments into the maintenance of buildings or equipment, development of new information and communication technologies like digitalisation, Internet, etc.) and production companies, distributors and exhibitors (investments into multiplexes, digitalisation of catalogues, etc.)
- **Loans for small and medium-sized companies** with lesser investment costs and **without risk sharing**, where EIB works with financial intermediaries rather than with the final borrower (for example, the “i2i Audiovisual” MEDIA Programme)

- **Loans for small and medium-sized companies** with a lower investment costs are also available in the form of credit lines **with risk sharing**, for example the credit lines of the Natexis Coficiné and Cofloisirs banks, covering the French market and also providing loans to the companies from other European countries. In other European countries the credit lines did not work out due to the small number of banks, specialised in loans in the audiovisual sector, and the establishment of such an instrument also depends on the establishment of a suitable legislative and regulative provisions by the state.
- **Pan-European venture capital funds**, specialised in the content industries¹⁵.

In accordance with the Treaty of Lisbon, in the year 2000 the **EIB Group**, consisting of the European Investment Bank and European Investment Fund¹⁶, established a three-year programme **Innovation 2000 Innovative**, in short **i2i**, for the encouragement of the European economy by developing knowledge and innovations. In the context of this programme EIB, together with the European Commission – MEDIA Programme developed the sup-

15 Deleau in Lange et al, 2004, 9

16 EIB, website

port “**izi Audiovisual**”, with the aim of ensuring the access of independent European production companies to external financing by the banks and financial institutions in order to cover the expenses of insurances, completion guarantees and financial costs of film projects. The programme was designed as aid in the geographical and technological development of film industry with the intention of strengthening it especially through international cooperation and consequently maximising the profitability of the sector¹⁷. With the year 2003 this programme developed into the *Innovation 2010 Innovative* programme (short: izi), whose goal is to mobilise up to EUR 50 billion for the encouragement of knowledge and innovation in the current decade. In the years from 2000 to 2006, EUR 45 billion of loans were granted¹⁸.

In the context of the izi programme, in 2001 an additional support mechanism of EIB was established: the **European Investment Bank Loan Framework** for the banks, supported by EIB as an additional creditor, which should increase the number of loans provided to the European film industry. However, only the French Coficiné and Cofiloisirs made use of this support, signing seven framework agreements with EIB in the average amount of EUR 20 million per agreement and in the total

amount of approximately EUR 140 million, by means of which 80 projects were supported. Nevertheless, despite the continued interest expressed by both banks, after 2007 the support by EIB was cancelled with the explanation that not enough banks responded to the call and that the administrative costs of the mechanism were too steep¹⁹.

With the year 2010 the **European Commission** established a new support mechanism: the **MEDIA Production Guarantee Fund**, which is to become operational on 1 January 2011. This Fund will be managed by an institution or a group of institutions, selected at the competition of the European Commission. In the next four-year period this Fund, with the total resources in the amount of EUR 8 million, will function as a partial guarantor for the bank loans provided to independent European producers. The goal of this Fund is to encourage the banks at the national level to actively approach the financing of film industry²⁰.

17 Deleau in Lange et al, 2004, 9

18 EIB, website

19 Baujard et al, 2009, 68-69

20 MEDIA Programme, website

