

# How to Fund Your Film: How Directors And Producers Can Secure Industry Financing For Films

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Since the first audience watched a motion picture flicker on a screen in 1895, the art of filmmaking has exploded into a megaplex of ideas and images that have entertained audiences for the past 103 years.

Over the years, film financing has become one the most complex and risky investments. Though it is easier for the DeMilles, Hitchcocks, and Spielbergs of the world to land financing deals, there are viable avenues for independent filmmakers to secure financing.

## **The Game Plan**

Once you decide on a project, it is imperative that you immediately choose your distribution platform (i.e. film, television or cable) and not wait until after the project is shot. This decision not only effects your budget, but it effects your equipment list and shooting plans. The next step is to memorize your distribution plan, which will become part of the pitch to your investors. This means that you will have to do research. You will need to find out the requirements for gaining distribution whether it be through a major, mini-major, independent studio, television or cable station. It is also a good idea to find out what type of films are regularly acquired by your potential distributor. By showing an investor a concise and detailed game plan along with enthusiasm, you will make them feel more comfortable in investing in your project.

## **Advantages and Disadvantages of Industry Financing**

The most obvious choice for film funding is industry financing. For example, there are studio development production deals, independent distributor financing, talent agency financing, end-user financing, and completion funds.

## **Studio Development Production Deals**

An in-house studio production will usually start as a development deal. As a filmmaker, you will first have to pitch the concept to a studio creative executive and then submit a synopsis of the project to the creative department. If the studio decides to finance the development, production, and the distribution of your project, then the studio will ultimately own most of the rights associated with your film.

When a studio gets involved in your project, you can expect a tough road ahead of you. The first phase will be a "Development Deal Memo," which is a short form written contract between you and the studio. The Development Deal Memo will simply outline the agreement, salary, time schedules, screen credit, and percentage points. Most studios will give points of the net profit to unknown talent. By doing so, this gives you a false sense of security while ensuring the studio to make as much money as possible.

Typically, net profit deals do not pay-off. Studios tend to juggle financing for different projects and use creative financing so most films do not "make money" (at least, on paper). For example, a studio will put the advertising budget of your film and that of another film in your budget creating an inflated advertising cost for your film. This means that the studio not only recoups their 30 percent distribution fee, but also recoups the extra money spent on the advertising that was not associated with your film. Therefore, the film's break-even point will be in flux enabling the studio to continue to generate money from your film. At the same time, their bookkeeping reveals a deficit to eliminate virtually any chance of the studio having to pay net profit participants their due.

The studio will make Development Deal Memo's contingent on a "Step Deal." A Step Deal is when the people working on the development of your project are paid incrementally as the project develops. In addition, the development work is reviewed and evaluated at each stage. This may sound great on the surface, but the real deal is that the studio has the right to stop development of your project at any given point.

However, a Step Deal offers you a few key advantages. You will be able to use the studio's money, as well as the studio's development companies. Because you are using these resources along with their professional script developer, you can ultimately make a bigger picture.

On the other hand, Step Deals offer many disadvantages. First, having Paramount actually pick up an unknown filmmaker's project is very slim. Second, there is the "Hollywood System," which is a relationship driven business. Third, there is theft! It is not uncommon for the studio steal your concept and have their development team work your idea in a new way. Therefore, you have to be careful with whom you share your ideas and to remember that scripts and treatments are copyrightable, but ideas are not copyrightable. Fourth, there is also the potential to lose your material to the studio if your project is delayed by the studio. Fifth, with Step Deals you can be fired at any stage, namely if you are not meeting the studio's schedule or if your work is not up to their standards. Once you are fired, you lose the rights to your project unless you negotiated properly before-hand. You must also protect yourself and your ideas against slipping into "Studio Limbo" (i.e. having the studio purchase a perpetual option on your project). Finally, you may run into a situation of not having your film adequately developed. Most studios tend to overbook the number of release pictures in a given year. If a studio picks up your film to meet their quota, then you can expect very quick development, production, and post-production time.

If you are seriously considering studio financing it is highly recommended that you hire an experienced entertainment lawyer. A seasoned studio executive will have more leverage than you and having a good lawyer on your side will only improve your situation.

### **Independent Distributor Financing**

An Independent Distributor is a distributor who is not regularly or substantially affiliated with a major studio. They specialize in foreign distribution and most are members of

AFMA (American Film Marketing Association). Although some have production divisions, they do not have the financial resources of a major studio. When submitting a project to an Independent Distributor, you must have some financing in place and be ready for principle photography. The reason being is that Independent Distributors do not have the resources to develop, produce, and distribute your project.

The advantages of Independent Distributors are few. First, they can distribute smaller films. Second, you can negotiate a better deal, because you and the distributor are on the same level. Third, they will offer more personal attention to you, as well as, support the film. Finally, you have a better chance of receiving net profits.

The disadvantages of Independent Distributors are that they have limited financial resources to put into your picture. This will impact the number of theaters in which your film will be screened. Also, you will have less collection clout with theater owners and overall smaller revenues. Lastly, Independent Distributors have a higher bankruptcy rate.

### **Talent Agency Financing**

Occasionally, you can obtain assistance in financing through talent agencies. A talent agency will package your film with two or more of their clients. They will do this primarily to increase their fee and the possibility of having the film being made. To ensure the success of the film, it is important to have the right package.

Talent agencies will not fund the project outright. Some agencies will help arrange financing through their resources such as, below-the-line facilities deals, international co-production deals, foreign government subsidies and presale arrangements. Through talent agency financing, you have more financial choices, whereas with a studio, all financing is done through that one entity.

One stop shopping is one advantage to using talent agency financing. Through the agency you may acquire actors, directors, and possibly a distributor. From the agency's point of view, this is not only good public relations, but it increases their chances of getting paid when the film is complete.

The disadvantage of talent agency financing is fierce – due to conflict of interest! First, the agency is attaching two or more clients to the same project. Second, the agency is arranging financing. Therefore, it seems like the agency is making the film for itself, rather than you, the filmmaker.

### **End-User Financing**

End-User financing is when a theater, cable or television station will put up money in exchange for equity percentage participation in the film's revenue stream for specific markets. This method is very similar to presale financing. With presale financing, the end-user does not put up any money until after the film is delivered. The amount of money put up by an end-user will have been pre-decided. The actual production money will come from a lender (i.e. investor, bank, independent distributor). Obtaining end-user financing through video and cable companies is called ancillary end-user financing.

Because video and cable companies rely on film product outside of the theatrical market, they are considered ancillary markets. The foreign market may be another possibility to acquire end-user financing. Foreign entities will purchase rights to films made in the United States.

The advantage of end-user financing is that you are in the best position to make money. Because the end-user is generating revenue in their own territory, they have the most control over this portion of the revenue stream. If you decide to go this route, you should ask yourself the following questions: a) who are the end-users; b) how much will they pay for specific rights; and c) what form will the investment take?

The biggest disadvantage is piecemeal financing. You will have to obtain commitments from a number of end-users to cover production costs. Also, established producers will have a better chance of obtaining both foreign and domestic financing.

### **Completion Funds**

Completion funds are designed to provide partial production financing or post-production financing. These funds can be provided for films that meet the following requirements: a) have completed principle photography; b) are complete except for post-production; or c) are complete through post-production, but can not be released from the lab due to unpaid lab fees. If you are obtaining financing through a lender, they will require a completion bond which will ensure the project will be finished. These funds rarely put up all the money needed to produce a film. Basically, they are sharing the risk with other investors.

Completion financiers successfully negotiate a higher per dollar percentage in the film. The reasoning is that, without the completion financing, the development and production financing has little chance of being recouped.

With this type of financing, your only advantage is that the completion financier is sharing in the risk as opposed to lending you the money.

Your disadvantages are two-fold. First, you have a weak bargaining position. Because completion grantors are providing the completion financing, they are in a better bargaining position. Secondly, completion fund financiers will not invest large amounts of money in your film because funds are limited.

For your information, Florida recently adopted a P&A (prints and advertising) Fund. Essentially, it is an incentive for filmmakers, such as yourself, to produce films in Florida. The Florida Film and Television Investment Trust Fund was established through private investments and state funds. This fund has the authority to invest three million dollars to be used on completing films that spent 40 percent or more of its production budget in Florida.

### **Conclusion**

These are some of the basic ways you can obtain financing for your project using various industry resources. However, there are many other ways filmmakers fund their film --

through grants from foundations (especially for documentaries and educational films/videos), individual and/or corporate investors, and, very often, out of their own meager pockets.

The next part of this article (in August 1998 issue) will discuss lender financing and include interviews with different local filmmakers about how they obtained financing for their projects.

Lender financing is one of the best ways for a filmmaker to secure funding for a picture without going through the studio system. Though lender financing is time-consuming and complicated, it is a great resource for independent producers.

### **Production Loans**

Lender financing is the process of obtaining a loan from a lending agency to finance the development, production, and/or distribution of your film. When you are looking for a loan, you must first find out what your state usury laws are. Basically, usury is an excessive and 'illegal' rate of interest on your loan. Unfortunately, the usury laws do not apply to studio loans. In other words, you might have to repay your loan with excessive interest.

Third-party feature film development loans or non-bank loans may be secured by some form of hard asset and are usually recourse to the borrower. In other words, the lender may seek repayment directly from the borrower, personally, in the event of a default. Now, if a corporate production company is the borrower, the lender may make the principals of the corporation personally liable. Also, other grantors may be required to assure repayment of the loan's principal and interest. In other words, one lender may hold a fellow lender responsible for repayment under certain circumstances.

With both bank and third-party lenders, you have a choice of loans. First, there is a resource loan, which is a loan made only if an endorser or guarantor (e.g., the producer) is made *personally liable* for payment in the event the borrower (e.g., the production company) defaults.

Second, there is a debt or equity transaction. With debt or equity transactions, you will have to make clear how the intended loan is to be characterized. For example, a loan to be used for development or pre-production expenses is classified as debt. The following are considered before a transaction is determined to be either debt or equity:

1. Is it a recourse or non-recourse loan?
2. Has a fixed repayment date been established?
3. Is the loan secured?
4. Is the rate of interest on the loan tied to the amount of profits earned by the film?

5. Does the lender exercise substantial control over production?
6. Does the lender take a subordinate position to third parties with respect to payments made from the film's revenue?
7. Does another lender have lent funds on the same or similar basis?

What is an equity investment? In equity investment, the lender actually becomes an investor whose investment is at risk. As a result, there may be no obligation for you to repay the loan. Transactions resulting in equity participation may result in your having to sell an

unregistered security to a passive investor. In addition, the creation of an entity (e.g., joint venture or association) may have to bear tax consequences.

### **Production Loan Advantages**

There are a few advantages with production loans: First, the lender does not share in the net profits; and second, the lender does not have any creative control. Also, you have the option of a non-collateralized loan, which is not supported by collateral and therefore may be suitable for development money or for financing an ultra-low-budget picture.

### **Production Loan Disadvantages**

The biggest disadvantage with all loans is that they have to be paid back! Most lenders will require that the production company incorporate to avoid usury problems. Also, you may lose your collateral, and non-collateralized loans are limited. Loans also have a specific term. In other

words, they are repayable on or before a specific date, regardless of whether or not the film made money! Another disadvantage is that as producer, you may be personally liable for the repayment of the loan along with the liability of the corporate production company. Finally,

sophisticated lenders will require that you contract with a completion guarantor to protect the lender against the risk of budget overruns.

### **Negative Pickup Deals**

The term "negative pickup" refers to the commitment made by a distributor to a producer to either purchase or license a film's distribution rights from you, the producer. The distributor guarantees to pay an agreed-upon price when the distributor picks up the negative after delivery of the completed picture. However, if a film is independently financed and presented to a distributor for pickup, then that transaction is referred to as an acquisition or pure acquisition, which is included in an Acquisition Distribution Agreement.

When using the negative pickup method for financing your production, you will sell and/or license the film to a distributor in exchange for the distributor's promise to pay an

agreed-upon price. You can then take the negative pickup distributor commitment to a commercial bank, use the pickup letter as collateral, and borrow production funds from the bank. This same tactic can be used to secure funding from investors. The letter demonstrates a distributor's strong interest in your production and provides the investor with an improved chance of recouping their investment.

### **Variables of Negative Pickup Deals**

There are a number of variables involved with negative pickups.

1. Did you receive an advance payment after signing the agreement?
2. Did you get paid after delivering the completed film?
3. Did the distributor provide a guarantee to you?
4. Finally, did you obtain perpetual participation in the film's revenue stream?

### **Producer Considerations for Negative Pickup Deals**

The first consideration is the purchase price. The purchase price is the amount you receive, which is based on the negative cost (the amount of money it cost to produce the film) of the picture. The second consideration is the amount of profit participation. The amount of profit participation is dependent on the amount committed to be paid by the distributor, the rights acquired, anticipated profits, and the risk of the distributor.

Other important considerations relating to Negative Pickup deals are listed below:

1. Delivery requirements. You and your attorney must examine the distributor's description of delivery requirements for the film, as well as required production element requirements. If these elements are not followed the distributor can refuse to pick up the film and the negative pick up agreement will not be acceptable to a financier.
2. Laboratory letter. A laboratory letter is a letter drafted by the film lab stating that the finished film is of acceptable quality, that the script adhered to the agreement, and that the pre-approved cast members appear in the final film in their proper roles.
3. Security for production loan or comfort for investors. You may be able to use the negative pickup as collateral on a production loan.
4. Distributors requirements.
5. Your net profit participation.
6. Criteria for delivery.
7. Distribution agreements similar to a P-F/D (Production-Financing/Distribution) deal. (The difference between the two is who provided the production financing.)

## **Negative Pickup Deal Advantages**

One of the advantages of a negative pickup deal is that in the event a studio enters into such an agreement, the studio has an obligation to pay if the negative is delivered according to the requirements imposed by the studio. This is also true regardless of the creative quality of the film. Negative pickup deals can be fairly easy to get because the distributor paid a fixed sum to obtain a complete picture that has certain agreed upon elements. This sum is not payable until the picture is delivered. Another advantage of a negative pickup arrangement is that the

distributor does not share in the risk of the film running over budget, because the completion guarantee is provided by the producer. The distributor in this arrangement holds little financial risk if the film is not delivered as agreed. Negative pickup deals can provide some assurance that the film will be released domestically. Finally, negative pickup deals removes the risk relating to the lack of distribution in financing.

## **Negative Pickup Deal Disadvantages**

The biggest disadvantage of a negative pickup deal is that you have to come up with the financing of the picture from sources other than the studio or distributor. A negative pickup deal is less expensive for a distributor to make a commitment to purchase the film before the film is

complete as opposed to after the film is finished. From the distributor's point of view, the negative pickup is a speculative deal. Negative pickup deals are very complex transactions and time-consuming. Also, negative pickup deals go to producers who have a proven track record and

established relationships with studios, distributors, and lenders. Negative pickup loans are generally only available through banks or other lenders. (Firms with the most expertise in this area and are based in either New York or Los Angeles.)

## **Presale Financing Deals**

Presale financing ("presales") is the funding of a film's production costs through the granting of a license for the film's rights by a producer to a distributor in a particular media or territory before the completion of a film. Presales can take the form of funds, guarantees, or commitments. For example, if you have a contract for the presale of your film to a domestic distributor, then you may be able to present the contractual commitments to a bank or lender and walk away with cash!

## **Presales Used to Finance Production Costs**

When you decide to use presales to finance your production, the first thing you should do is obtain an experienced sales agent to make the presale arrangements on behalf of the film. As producer, you can expect the sales agent to receive a 10 percent to 20 percent deposit at the time of signing. The agent may also want to get a minimum guarantee payable on the delivery of the picture to the buyer. The sales agent will typically get a presale agreement that is sometimes backed by the presale purchasing entity's letter of

credit or other form of financial guarantee. You may be required to assign a portion of the picture's net profit to the grantor for providing the guarantee.

With this agreement in hand, you may then go to a lender and use it in conjunction with distribution agreements and guarantees, other presale agreements, or other forms of collateral to obtain a production loan. You may borrow money by pledging the presale agreement itself. In general terms, a letter of credit is considered more bankable than a contract to pay the same amount of money.

Ultimately, a lender will decide to lend on a given presale agreement independently based on the reputation and track record for the presale purchasing entity and the terms of the agreement. Also, once the lender determines the amount, the lender then discounts the loan amount to get the production funds.

The quality of the picture, the competitive environment, and the demand for that genre of picture will determine whether or not the sales agent can sell your picture. Genre, censorship, the amount of deposits paid by the buyer to the sales agent are the primary concerns that relate to what rights are included in the presale agreement.

It is best to contact a sales agent as soon as possible. The sales agent will need a completely packaged film before he/she will be taken seriously by a potential purchaser.

### **Presale Financing Advantages**

Presale agreements can provide for a big portion of production financing. Also, there is less creative intervention. Presales involving loans do not have the kind of creative control issues that a studio-financed production imposes on the producer/production team. If you are not confident in the economic upside potential of your picture, then a presale arrangement is a viable option.

### **Presale Financing Disadvantages**

Since presales are based on contingencies, collecting the money from the lenders can be difficult. Also, increased prints and advertising (P&A) costs make presales less practical. Moreover, domestic presales may eliminate certain distributors. Domestic distributors insist on all or substantially all rights of a picture to help recoup their costs, not only of advances to the producer, but distribution costs as well. Ancillary rights that have significant value may be demanded by the distributor as a prerequisite of distribution. Presales bring lower prices, since the buyer will pay less for a film before it's completed. Finally, feature films financed with presales not only increase the number of films produced in a year, but they increase the demand for and cost of various film elements that are limited in supply. There are more films produced each year than there are capable and willing distributors to distribute. This creates an oversupply of films, and as a result, creates an imbalance in the bargaining strength between you as producer and distributor.

### **Conclusion**

As you can see, lender financing is both time-consuming and very complicated. When deciding how to finance your film, you must seriously consider all forms of financing, the

reason being is that each producer's situation is unique. The bottom line is that you get your message out.

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