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Work Session VI: When Professional Sports Come to Town: How you can Build a Stadium, Negotiate the Agreements, and Finance the Project

Presented by:

David S. Abrams
Principal and National Director of Sports, Strategic Advisory Group Clinical Assistant Professor of Sports Management, Tisch Institute for Sports Management, Media and Business, New York University

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STRATEGIC ADVISORY GROUP–PUBLIC FACILITY FINANCING EXPERTS
STRUCTURING A SPORTS FACILITY IN THE PUBLIC SECTOR

David S. Abrams
Principal and National Director of Sports, Strategic Advisory Group
Clinical Assistant Professor of Sports Management, Tisch Institute for Sports Management, Media and Business, New York University

SPORTS FACILITY EXPERIENCE – CITY AND COUNTY GOVERNMENT SPONSORED PROJECTS

We have a broad array of experience working for both private sector entities (the teams or parent company developers) and the public sector across the 5 major sports leagues in the United States, colleges and universities and minor leagues. Most of our work has been on the side of the public sector entities but occasionally, we participate on behalf of the private sector. David Abrams has completed duties as advisor to the Houston NFL franchise (the Texans) regarding the development of a new NFL stadium. David has served the franchise ownership group for a number of years and has participated in the negotiation of many major transaction documents as well as participated in structuring both the private and the public financings for three major venues in Houston. David recent completed an assignment advising the Atlanta Falcons Football Club in the public funding portion of the New Domed Stadium Project in Atlanta.

David also advised the City of Jacksonville on negotiations to bring and NFL team to that city and in the development of an NFL Stadium. He has also advised the Tampa Bay Buccaneers and Miami Dolphins organizations on the development and financing of their NFL facilities. In the area of indoor arenas, David has been involved in various capacities with the Broward County Civic Arena in Sunrise, Florida; the sale of Madison Square Garden; and the financing of the Pepsi Center in Denver, Colorado.

SAG APPROACH TO PUBLIC PROJECTS

We take a bit of a different approach to major sports civic projects than many of our investment banking counterparts do. We seek engagements where we can become involved early in the process so that we can participate in the development of key transactional components that eventually serve to strengthen the financing and protect the bond rating of the underlying public sponsor. In our experience with other public sector sponsors, we have generally found the following ***four points as integral to a successful community venue projects:***

1. LIMIT CONSTRUCTION RISK

- Define the maximum public contribution to construction of the facility and limit this contribution via legislation, or
- If there is not a maximum limit on the public contribution defined, do not finance until the design process is at least well into the construction drawings phase combined with an adequate construction contract resulting in a project delivery system where the contractor is at risk.
- Define the team/tenant or contractor obligations for insurance, damages, bonds, and construction fund draw oversight provisions.

- Define the timing needs for private financing components (i.e. at or before public financing is completed), including identification of a mechanism for securing funding for cost overruns.
- Be certain that all project components are known and funded up-front if possible.

2. MAXIMIZE PRIVATE CONTRIBUTION AS A REFLECTION OF YOUR MARKET

- The negotiating team must understand professional sports team and facility economics and how individual market constraints affect the economics of the overall financing plan for the project(s).
- The negotiating team must understand how to best leverage private and public revenue streams by understanding federal tax law, state and local public law, and other real estate criteria.

3. LIMIT OPERATING RISKS

- Limit public contribution for capital repair obligations.
- Unless otherwise necessary for financing plan reasons, the public should agree to no on-going operational cost obligation.
- Identify new funding sources for all new public obligations.
- Emphasize "play" or "non-relocation" covenants.

4. NO IMPACT ON UNDERLYING RATINGS

- Do not alter regular debt management policies or strategy.
- Identify new public revenue streams to fund new public obligations.
- Make development of new stadium facility(ies) consistent with overall city and countywide development plan.
- While understanding sports economics is an important component in negotiating a favorable business deal, resist the temptation to concentrate on sports economics and be attentive to limiting construction and operating risk.

SAG Public Facility Experience – Lessons Learned

The assembly of the financing plan for major sports facility civic projects is complex. It is difficult for local public officials to adequately address the immense issues these projects bring to bear without assistance from those that can offer the benefit of actually having lived through similar projects from early in the process, through day-to-day construction and into the operational period. You may have noticed significant cost overrun issues on similar recent projects in other communities. Below is a brief listing of our observation of lessons learned by public officials from participating in major sports facility civic projects:

- Lack of attention to limiting risk during construction leads to direct financial liabilities of the public, contentious negotiations over responsibility for additional costs to complete the facility at a time when all parties should be celebrating the creation of a new civic asset, or excessive team leverage when negotiating other significant points.
- Lack of clear identification of all obligations of public and private parties (e.g. infrastructure, environmental, site preparation, planning costs, project insurance, etc.). These conflicts may arise between private and public or between various public partners.

- How does the plan accommodate increases in the cost of land acquisition or other public components away from the facility?
- Lack of attention to operational risks may lead to unforeseen liabilities in future years.
- Lack of attention to maintenance and capital repairs may lead to unforeseen liabilities created by deterioration of the facility.
- Many public officials are attracted to the glamour of negotiating with team owners or the novelty of naming, sponsorship, or other sports and entertainment facility financing arrangements and therefore lose site of the importance of other, larger, components of the financing plan, intergovernmental, or business arrangements.
- Lack of completion of definitive documents prior to a major transfer of leverage event (e.g. acquisition of property or completion of public financing arrangements) leads to the weakening of the public's position when negotiating key components of the transaction
- Granting of approval rights (on design, financing arrangements, etc.) leads to the creation of undo team/tenant leverage in negotiations.
- If the completion of private financing arrangements is not required prior to the consummation of public financing arrangements, then credit weaknesses to the public financing or the shifting of business transaction leverage will result.

KEY FACTORS IN SPORTS FACILITY SUCCESS

We have attached three brief outlines of various issues integral to sports related civic projects. The following includes an outline of key Sports Facility Financing Plan Criteria and Components of a Successful Financing Plan and an outline of important issues to include in a memorandum of understanding with the team/tenant.

SPORTS FACILITY FINANCING PLAN CRITERIA

OWNERSHIP RISK SHOULD BE CAREFULLY CONSIDERED BY THE LOCAL GOVERNMENT:

- Should an asset requiring considerable public subsidy be owned by the public?
- Is the creation of a new sports facility as a public asset appropriate public policy?
- Negotiations should target minimization of public obligations to pay taxes, insurance, and on-going maintenance.
- How are long term capital repairs going to be handled in the negotiation?
- Term of operating leases should be tied to any bonded indebtedness.
- Creation of divided ownership interests has been a way of building additional private money into financing plans while maximizing tax-exempt debt capacity.

ISSUER DEBT MANAGEMENT POLICY NEED NOT BE AMENDED TO ACCOMMODATE A SPORTS FACILITY CIVIC PROJECT FINANCING PLAN:

- Special purpose entities are often created to act as bond issuer.

- Rating agencies carefully consider the obligations of local government sponsors even if a third party issuing entity is involved.
- Local government sponsors should structure direct obligations consistently with its regular debt practices to guard against risk of rating downgrade.
- Rating analysts will consider whether or not revenue streams identified for civic project obligations lessen the flexibility of the local government sponsor to meet it's other debt and programmatic obligations.
- Many major civic projects, such as sports facility developments, have been viewed positively by rating analysts.
- The "essential purpose" nature of the facility will be questioned by rating analysts. This is an argument that is difficult to win with the analysts. Hence it is critical to note how obligations of team/tenants are assured; how new revenue streams do not negatively impact current programs or the ability to pay debts; and how facility risks do not fall onto the local government sponsor.
- Creation of a comprehensive financing plan with multiple partners covering construction and operating risks is a must.

MANAGING THE TAX STATUS OF THE FINANCING PLAN HAS FINANCIAL, BUSINESS DEAL, AND OWNERSHIP IMPLICATIONS:

- Public sector ownership does not mean the project necessarily avoids violating private activity rules – likewise a long-term lease with a private user does not necessarily mean tax-exempt bonds cannot be issued.
- Private payments can be structured to be received during construction as "return" on up-front public equity contributions.
- Facility ownership structure can be divided to bifurcate public ownership and payments to tax-exempt financing from private ownership and payments to taxable financing.
- Public operating obligations may be offset from private payments lessening the impact of private payments from a tax analysis perspective.
- For exceptional credits, taxable bonds are more expensive than tax-exempt bonds in today's market (comparable credit). The tax-exempt/taxable interest rate spread may be considerably larger for transactions of lesser credit quality. Obviously the ability of tax-exempt bonds to create much more leveraging capability often alters the business deal relationship among the parties.
- The public security of an "air-tight" long-term lease is generally seen as a business point not altered in an attempt to garner additional tax-exempt bond capacity (via shorter management contract parameters of the private activity regulations).

COMPREHENSIVE FINANCING PLAN MUST TAKE INTO ACCOUNT IMPACT OF:

- Development cost estimate (status of facility design at the time the budget is developed), environmental liabilities, prospects for a project-labor agreement to guard against work stoppages, ancillary project costs (builders risk insurance coverage, construction period

utilities, testing and inspection, other general conditions, etc.), adequate allowances for program elements not fully designed, and adequate contingency funding;

- Construction program (tenant's desires and revenue generation needs);
- Construction timing needs;
- Construction method (GMP, Design-build, parallel prime (fast track), etc.);
- Construction control, responsibility for overruns, MBE/FBE/local resident issues;
- Public infrastructure and parking needs;
- Public purpose nature of surrounding infrastructure improvements, negotiation of easement rights and resulting financing and control issues;
- Exemption from state and local sales taxes on construction, or applicable permit fees, if the owner is a public entity;
- Prevailing wage limitations;
- Tax status (Congressional proposals, current IRS regulations) of public securities issued to fund construction; and review of similar laws in the case of international developments;
- Public issue disclosure requirements, potential for exemption from registration of securities for issuance leveraging private revenue streams, and team/tenant/developer desire for confidentiality;
- Identify the tax impact of the timing and structure of public money contributions to the project;
- Tax impact and other financing considerations of various structures of private payments;
- Asset allocation issues revolving around various structures of private payments;
- Understanding that background of sports team and facility economics is essential to even-handed negotiation but that sports team and facility revenues will contribute but a minor portion of the overall financing plan – understanding how to identify and implement key public sector financing and funding assets is the key to a solid financing plan;
- Defining the nature of the available funding for the project, the timing of that funding or the need to structure temporary or permanent financing for that funding;
- Identify other available funding for the project, public or private, such as research of available tax streams under state or local law, general estimate of revenue generation from such sources, preparation of pro forma statements;
- Determine if independent status from other debt issuance of the owner entity is desired. In addition, assure no conflict with other financing arrangements;
- Determine need for reserve funds, potential for surety in lieu of cash bond reserve;
- Flexible provision for early retirement of any financing arrangements in case of revenues exceeding expectations;
- Use of capitalized interest or current revenues to fund construction period debt service;
- Suggestion of project consultants and preparation of requests for proposal for such consultants;
- Lease/rental structure with team, other tenants or subtenants;
- Responsibility for operating costs, utilities, current taxes, future changes to current tax rates, capital repair, property taxes and insurance;

- Adequate post-construction insurance coverage with adequate coverage for additional insureds;
- Will bond documents interface directly with transaction documents - if so, prepare documents to be flexible enough to accommodate changes; and
- Be certain all sources of funding/financing accounted for - are additional bond provisions adequate in bond documents and what is the credit impact of these provisions.

STRUCTURING A MEMORANDUM OF UNDERSTANDING

Perhaps the first major threshold crossed when embarking upon a new sports facility civic project is agreeing to basic terms of the business deal between the primary public sponsor of the project and the primary facility tenant (generally a professional sports team). From the public's viewpoint, it is critical to negotiate as many terms of the basic transaction early so bargaining power can be maintained throughout the project life. A memorandum of understanding between the primary parties often is the vehicle that evidences the summary of basic terms and conditions related to the development of a project. Public sponsors should check with their legal counsel as to whether to structure a memorandum of understanding as a "binding" or "non-binding" agreement. Whether or not the specific document detailing the memorandum of understanding is described as binding or non-binding, the negotiated terms described in the agreement generally hold through the time that definitive documents are executed.

Beyond standard form components of the document (recitals, definitions, miscellaneous terms such as agreement as to how to amend of the document), a memorandum of understanding is comprised of eight major areas describing the basic business agreement of the primary project sponsors. Specific characteristics or conditions existing in a community may create the need to include other specific areas of agreement such as site location and control, but the nine general areas are identified as:

1. Design and Construction of the Project
2. Project Budget
3. Financing Plan
4. Revenue Sharing Agreement
5. Operating Responsibilities
6. Event Management
7. Capital Repair and Replacement
8. Dispute Resolution
9. Non-Relocation

Below is a discussion of key points describing each of the nine major topics covered in a typical memorandum of understanding of basic business terms and conditions for a sports facility civic project.

1. DESIGN AND CONSTRUCTION OF THE PROJECT

- If the responsibility for the construction work and funding are obligations of a private entity, delineate carefully the minimum expectations regarding the quality of improvements. For example, specify that new construction (or renovation) is expected to be completed consistent with the industry standard for recently completed new projects.
- Describe the general construction arrangements such as the coverage of cost overruns; the expected project delivery system; the methodology to be used for selection of contractors and consultants and who will have privity of contract with contractors and consultants (e.g. establishment of selection criteria, etc.).
- Note the priority of state law provisions as it relates to any public contracting arrangements.
- Identify how the design process will work. That is, identify which party is primarily responsible for selecting and managing the design team. Also, there should be clear agreement as to how the parties will interface with each other during the design process; i.e. which party will have final approvals of design concepts, etc.

- Describe the construction draw process. Note how the parties will work together to review the budget and the progress of construction. Finally, describe how the construction draw mechanics will interface with the bond documents.
- Outline of project schedule, i.e. the design, financing, and construction.
- Be clear about intentions of public sector to utilize eminent domain if necessary.
- Identify, to the extent possible, minimum design requirements for new construction.
- Make sure any non-discriminatory, resident, or other specific local contracting goals and obligations are included if so desired by the public sector partner.
- Note prevailing wage application where required or desired.
- Resist "obligating" third parties you do not control for performing some service or providing financial resources (e.g. "causing" a third party to perform).
- Describe force majeure events – make sure unforeseen environmental and litigation are included as events of force majeure (they are not always).
- There will be tremendous pressure to identify a completion date – a party not solely responsible for all design and construction obligations should not acquiesce to penalties for missing completion deadlines. All parties not directly in control of the contractor should merely agree to use best commercially reasonable efforts to complete the project by a given date.
- Discuss any requirements involving the completion of ancillary developments if such development activity is a material inducement for a party (such as the public) to enter into the business deal (e.g. public infrastructure or private ancillary development). Such development activity should be described to the extent possible and development criteria should be identified, such as development guarantees, timing requirements, a description of the design approval process, etc. Depending upon the agreement, defaulting on ancillary development obligations may create a default against the basic transaction or create penalties including liquidated damages.
- Make sure any major project contingencies are identified (impending new tax, sewer or water restrictions, other specific initiatives).

2. PROJECT BUDGET

- Define the project scope in as detailed a form as possible, including all ancillary infrastructure or related development work (utilize whatever conceptual design work that has been done to date).
- Identify interim project costs and which party will take responsibility for temporarily or permanently funding such costs (e.g. planning, capital, consultants, options on land).
- Include ancillary project cost in the budget, including (but not limited to) project insurance, testing, site preparation, environmental testing and remediation, infrastructure relocation and/or improvement, parking, etc. If the cost is listed, an identified party will become obligated to construct, fund, or otherwise provide for it. If the item is not listed, generally the public becomes responsible for providing for it.
- Identify major construction risk mitigation items (payment and performance bonds; project insurance; liquidated damages; delay-in-startup builder's risk insurance; environmental testing and remediation; etc.) and which party will be responsible for providing for these items.

- List the original project cost estimates and how the project will be funded – specifically identifying limitations on funding such as funding caps either established as a business matter or legislatively.
- Discuss the provision of other public services during construction (such as parking, security, utilities, lighting, fees, priority processing, traffic control, etc.), limitations on these services, and the impact of the provision of these services on the budget.
- Resist the inclusion of parking obligations as a project contingency. The parties can agree to cooperate to find adequate parking within "x" blocks of the facility, but the location decision for the facility should be based in-part upon parking considerations.

3. FINANCING PLAN

- Identify all owners, managers, and financiers involved in the project to the extent possible. Clearly define the obligations of all financing partners – do not commit to picking up the slack for parties you can't control.
- Note all agreed upon financing contingencies, such as land acquisition, environmental or soil conditions, title conflicts, new legislation, voter approval, public body approval, private board approval, sports league or governing body approval.
- Note the priority of state law provisions as it relates to public financing arrangements.
- Make sure all financing arrangements and project timing considerations (primarily contracting) account for required amendments to state law provisions if such changes are necessary to accommodate the financing plan
- Describe to the extent possible the financing arrangements or parameters in which the financing arrangements will be based. Identify if the financing will be a project contingency. Lay out the terms of the financing arrangements to the extent possible or give yourself the opening to be reasonably satisfied with the financing terms and conditions (in your sole and absolute discretion). When describing the threshold terms for the projected financing arrangements, be conservative since renegotiation will cost leverage. Make note of any required security interests; revenue sharing breakdowns; maximum maturity; governmental or third-party credit enhancement (if any); team/tenant guarantees; and specific provisions related to the timing of the deposit of proceeds.
- Resist contractual language that provides for the approval of financing arrangements. Instead, require full financing arrangements to be deposited simultaneously so that one party is not at risk for lack of completion of the other parties' financing arrangements.
- Note any required (or expected) equity contributions.
- Describe the revenue sharing arrangement regarding the facility as it specifically relates to the financing arrangements. Also list all rental arrangements, financial, operational, repair, or fiduciary obligations of the parties.
- Note the disposition of any excess funds from construction funds and describe how those funds will be put to use (e.g. retire bonds early, capital repair reserve deposits, etc.).
- Identify in the discussion of financing arrangements what liens on property will be permitted, if any. This discussion may also include limitations on liens on revenues streams depending upon the financing plan and/or statutory concerns.

- Identify requirements for operating period insurance, such as liability, property, and business interruption. Tie the disposition of net proceeds from the insurance to the financing arrangements where appropriate.
- As part of the financing arrangements, note any completion guarantees required as a business matter, pursuant to legislation authorizing the project, or as a financing contingency.
- Note the timing of the respective parties' obligations with respect to the timing of bond payments. Also be sure to provide for impact on transaction documents of any refinancing of the public (or private) financings.
- Note any contingencies of, or dependence on, local or state legislation regarding generally applicable taxes, special taxes, limited taxes or fees, etc. as they may impact the financing arrangements (e.g. tax status of public bonds).
- Describe force majeure events as they specifically affect the financing arrangements. Make sure that unforeseen environmental issues and litigation are included as events of force majeure.
- Account for player work stoppages. Do not allow player work stoppages to be a force majeure event.
- Require that the team/tenant maintain their status of good standing as a member of their sports league and within the guidelines of their governing body.
- Require all transaction documents (list those contemplated) to be executed prior to financing arrangements.

4. REVENUE SHARING AGREEMENT

- Identify the major economic drivers of the facility to be developed and make note of which party will receive the revenues; which party will own title to a specific revenue stream; and which party will have rights to market and license a specific revenue stream.
- Describe the revenue sharing arrangement regarding the facility. Also list all rental arrangements, financial, operational, repair, or fiduciary obligations of the parties.
- Specifically note provisions regarding the granting of air rights pursuant to the agreement.
- Specifically note whether or not the image of the facility will be leased or rights granted to a party pursuant to the agreement.
- Note how any post-construction "excess" revenues will be disposed of. These revenues could be in the form of special taxes or on-going facility revenues.
- If part of the revenue sharing agreement, discuss any particular agreement regarding the sharing of franchise sale proceeds – as an example, if the franchise were to be sold within a certain number of years since completion of the project perhaps the public may share in sale proceeds by agreement.

5. OPERATING RESPONSIBILITIES

- Outline the agreement regarding provision of maintenance services to the facility and note the procedure used to evaluate the provision of those services (e.g. industry standard, engaging an engineer to audit the provision of maintenance services, etc.).

- Identify all owners, managers, and financiers involved in the project to the extent possible. Clearly define the obligations of all operating partners – do not commit to picking up the slack for parties you can't control.
- Describe the term of the agreement related to operating the facility. It may be important for tying the term of the operating agreement to the term of the financing.
- Specifically describe major defaults and termination clauses as if negotiating the definitive lease. Specifically cross-reference the "play" or "non-relocation" covenant.
- Describe the process related to removal of tenant property if so installed in the building.
- Describe the agreement regarding the selection, installation, and management of all signage, sponsorships and events to track local ordinances and good taste standards.
- Resist "obligating" third parties you do not control to perform some service or to provide financial resources (i.e. "causing" a third party to perform).
- Resist price controls. Price controls may be used to influence pricing of an item not under the direct control of the team/tenant, such as parking rates.
- Note, to the extent possible, the tax status of the new facility and/or surrounding grounds. Resist limiting the imposition of other taxes (particularly taxes of general application) or in any way compensating the team/tenant if new taxes are implemented.
- Identify requirements for operating period insurance, such as liability, property, and business interruption. Tie the disposition of net proceeds from the insurance to the financing arrangements where appropriate.
- Describe force majeure events as they relate to the operation of the facility – make sure unforeseen environmental conditions and litigation are included as events of force majeure.
- Account for player work stoppages. Do not allow player work stoppages as a force majeure event.

6. EVENT MANAGEMENT

- Describe event management and promotional responsibilities of the parties. Note how many events each party will be responsible for staging, or how many dates each year the respective parties will retain for the staging of events.
- List how much time prior to and after the event each party will have for access to the venue.
- Discuss the scheduling of events and the notification of such scheduling.
- Discuss the management of revenues, expenses, and other obligations for events that are not the main responsibility of the team/tenant.

7. CAPITAL REPAIR AND REPLACEMENT

- Specifically identify each party's capital repair responsibility – such as the party actually performing the repair, the party responsible for the funding of the repair itself, and the party responsible for the depositing of proceeds into a capital repair reserve fund.
- Describe parties' obligations to make regular deposits to renewal and replacement, maintenance, preventative maintenance, or capital repair funds.
- Designating the party primarily responsible for on-going maintenance as the same party primarily responsible for capital repairs mitigates an inherent conflict generated if different parties are responsible for the respective obligations of regular maintenance and capital repair.

- Provide the party not directly responsible for providing capital repairs the ability to perform self-help or audit.
- Note that the quality of capital repair improvements should track the initial improvements or industry standards.
- Describe the disposition of tenant property if it is so installed in the building.

8. DISPUTE RESOLUTION

- Outline specific means for resolving disputes among the parties (e.g. arbiters, local jurisdiction, etc.)

9. NON-RELOCATION

- Specify that the team/tenant must play its home games (plus appropriate exhibition and playoff games) at the project site and that, if the team/tenant does not comply with this provision, a local court will provide injunctive relief to the public project sponsor by requiring the team to live up to its contractual obligations. Do not limit the remedies for this event of default to payments of money (liquidated damages).