Municipal Development of a Multi-Purpose Entertainment Venue as a Public Private Project

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Author Note

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Abstract

In late 2014, the City of La Porte (CLP) received an opportunity to develop a public-private project (PPP) by funding a $50 million multi-purpose entertainment venue (MPEV), also known as a coliseum, stadium, or arena, as a anchor/catalyst to develop a proposed one hundred acre mixed-use development. Before making a commitment to such an expensive project, the CLP wanted to identify: (1) how much capital is appropriate for a community to invest in this type of PPP, (2) what financial tools are available to fund these types of PPPs, and (3) what are the "best practices" and/or "lessons learned" that communities, which have successfully completed similar projects, have discovered? In order to obtain answers to these three questions, the CLP interviewed professionals in nineteen communities about twenty different MPEVs, using a total of eight survey questions. Owning and operating MPEVs can be very expensive and risky investments. Communities, which have correctly assessed the risks with developing MPEVs and put funding mechanisms in place to support the projects, have had rewarding experiences. Many public entities, however, which have failed to take the investment risks associated with MPEVs into consideration, have had to find uncomfortable ways to fund this unexpected financial burden on an annual basis.

Keywords: Multi-use public venue, coliseum, arena, stadium, public private partnership, public private project, incentives, bonds, development, municipal, lessons learned, best practices, survey, APA format, and sixth edition.

Municipal Development of a Multi-Purpose Entertainment Venue as a Public Private Project

In late 2014, the City of La Porte (CLP) received an opportunity to enter into a public-private partnership (PPP) by funding and building a $50 million arena, or multi-purpose entertainment venue (MPEV), as part of a one hundred acre mixed-use development with retail, restaurant, sports, entertainment, office, hospitality, convention center, and residential uses. The proposed MPEV would host conferences, graduations, concerts, theater shows, family shows, rodeos, bull-riding, circuses, professional wrestling events, professional and amateur sports, and many other forms of live entertainment. The increased visitation would attract tourists and customers to the MPEV as well as the new retail and restaurant businesses in the mixed use development. Before making a commitment to fund and build the fifty million arena, the CLP wanted to identify: (1) how much capital is appropriate for a community to invest in this time of PPP, (2) what tools are available to fund these types of PPPs, and (3) what are the “best practices” and/or “lessons learned” that communities, which have successfully completed similar projects, have discovered?

Method

Participants

The CLP conducted research online about each of the ten projects, where the developer of the proposed MPEV had completed a project in the last ten years. Over the course of the interviews with professionals in each of the ten communities, the first group of participants referred the CLP to ten other projects, which were recommended to be helpful on this subject.

Procedure

All interviews were conducted by phone and/or e-mail, using only the eight questions listed in Appendix A. Depending upon the community, the CLP interviewed the city/county manager, director of economic development, director of community development, director of finance, director of parks and recreation, or other city official responsible for protecting the community's interest in the MPEV.

Results

Of the twenty projects, direct responses were received for eighteen projects. For the remaining two projects, which repeatedly refused to offer any feedback, the CLP found incomplete information about their projects online. The following characterizes each of the twenty projects in the survey sample: (a) A population less than 200,000, while thirteen of the communities had a population less than 100,000; (b) MPEV with 4,300 - 10,800 seats, while sixteen had 5,000 - 9,000 seats, one had fewer than 5,000 seats, and three had more than 9,000 seats; (c) The average cost of construction cost for each MPEV was **$55.5 million**, which is unadjusted for inflation; (d) The projects were spread across eleven states including Washington, Arizona, New Mexico, Colorado, Kansas, Texas, Missouri, Michigan, Ohio, Illinois, and Pennsylvania; (e) Each of the projects opened from 1993 to current; two of the projects opened before 2000, fourteen opened from 2001-2009, and four opened in 2010 or later; and (f) One or more public entities, such as the city, county, state, and/or federal government, paid for the total cost of twelve projects. In addition to receiving financial support from the municipality, five projects received financial support from the **county**, three received financial support from the **state**, and two received financial support from the **federal government**. For the eight projects, which were not completely funded by public entities, private parties contributed an average of **26.275%** to the project.

Financial Tools

Public entities may use a wide variety of tools to fund the development of the MPEVs.

These tools may include, but not be limted to, the following: local sales taxes/funds/reserves, local sales tax rebates, county sales tax rebates, state sales tax rebates, sales tax revenue bonds issued against the local sales tax levy, funds from the economic development corporation, funds from the community development corporation, hotel/motel taxes/funds/reserves, local hotel/motel tax rebates, state hotel/motel tax rebates, revenue bonds issued against the hotel/motel tax levy, public improvements, streetscape funding, infrastructure funding/ reimburements, PIDs, PUDs, MUDs, incremental sales tax from special districts, ad valorem and business personal property tax, property tax abatements and rebates, TIRZ/TIF funding and/or reimbursement for infrastructure and economic development projects, revenue bonds issued against the property tax levy, private real estate contributions, other private contributions, the city's general fund, certificates of obligation, general obligation bonds, funds from the drainage, water, and other utility funds, bond rate arbitrage (not allowed in all states including Texas), long term land/ground leases, operator/user lease payments, annual operator's fee, annual tenant(s) fee(s), dedicated user fees, a facility fee on every ticket sold, admission tax or surcharge per ticket, admission tax per event, admission tax on gross sales, venue tax on local car rentals, parking garage leases, parking garage revenues, all sales tax from tickets, concessions, and merchandise, contractually-obligated revenues like naming rights, which are a source of revenue that may be used to both service the debt and guarantee bonds. By contract, obligated revenues need to be connected to the building, rather than the operator. It is important to consult with your attorney and comply with all applicable laws.

Best Practices and Lessons Learned

The twenty projects surveyed shared "best practices" and/or "lessons learned" in developing, operating, and owning a MPEV: **(1)** Hire a consultant to complete an objective, independent, and rigorous feasibility study for the MPEV to realistically determine the quality and quantity of entertainment events that are likely to use the MPEV. The study must consider other competing venues and determine the breadth and depth of the market to support the proposed MPEV. Discard both the most favorable and least favorable estimates for the MPEV's success; only the estimates in the middle are the most reliable. Place full value in the independent reviews regarding the MPEV's economic viability. Don't fail to disclose all truthful and un-revised financial projections. Don't revise the figures upward, based upon optimistic assurances by civic leaders that the community will support the project; **(2)** Include both the city's financial advisor and bond rating analyst from the very beginning of the project. Before the city considers pledging its full faith and credit to guarantee or underwrite the development of the proposed MPEV, make sure the city has the available bond capacity; **(3)** Hire an outside real estate attorney that specializes in real estate and public private development to work with the city's attorney on the project. Use the outside legal counsel to negotiate, develop, and review all development agreements from the beginning. Hire a large enough firm that will be able to carry the city through any potential, legal fight; **(4)** Consider putting the proposed project to develop a MPEV, or issue bonds, out for a vote by public referendum. Approval of the voter referendum may be needed to weather any future political storm; **(5)** If the community holds a voter referendum to obtain authorization from the voters to fund the development of a MPEV, include "the construction, design, maintenance, and operations of the MPEV" in the ballot language; **(6)** Consider purchasing land with general fund reserves to avoid limiting the uses that may be tied to a bond issue; **(7)** The MPEVs that struggle the least with covering the annual debt service are those whose total costs to develop the MPEV were heavily subsidized from the beginning. Therefore, enlist private investors, private donors, one or more professional sports franchises with good, strong credit, and/or the county, state, and/or federal government to subsidize the cost of the project; **(8)** Secure the first lien on the MPEV to protect the public's investment of capital; **(9)** Publicize the community's interest in developing a MPEV to the private development community. Distribute a competitive RFP to prospective master development partners, professional sports franchises, and/or other private investors that will invest "at risk" capital in the development of the MPEV; **(10)** In Texas, abide by Chapter 2267 of the Texas Local Government Code, which outlines procedures for executing a public private partnership to develop a publicly-owned project; **(11)** Establish a committee to include city staff, board members of the local development corporation, and city council members to collectively guide the process to develop the MPEV, select partners, negotiate contract terms, and maintain oversight over development partners and the operator; **(12)** Evaluate all master developer proposals based upon their: (a) experience and expertise, (b) proven success on similar projects, (c) recommendations from references on completed projects, (d) financial capacity, (e) a pre-scribed minimum amount of capital to be invested "at risk" in the project, (f) ability to bring a team/tenant to the project, (g) a plan to attract what the community wants and needs to the MPEV, (h) ability to develop the retail and restaurants with the MPEV, and (i) a proven ability to deliver and operate within budget constraints; **(13)** Require each master developer to demonstrate his/her specialties. Hire an outside firm to "vet" each master development partner finalist. Personally conduct in-depth due diligence by traveling and examining some of each developer's completed projects; **(14)** Ensure that the selected master developer's financial plan is simple and realistic, rather than complicated or highly leveraged; **(15)** Hire a consultant to objectively examine and verify that the master developer's development plan is sound and realistic; **(16)** Draft and execute contractual agreements, that are performance and/or fee-for-service based; **(17)** When multiple development partners and investors are involved in the project, the city must be able to unwind the PPP structure if one or more development partners or investors cannot meet his/her obligations. Therefore, structure the PPP so that public funds don't pass through the master developer to the other partners. Execute all contracts as multiple party agreements with the city, which give the city unilateral "step-in" rights to bypass the master developer, break the contracts, and take action to break away from the master developer, and save other elements of the project; **(18)** Solicit one or more, strong, well-capitalized tenants that will enter into long term leases for the facility. Find a sports niche that will be successful in the area, pay a substantial amount of rent, and attract large numbers of people for a maximum number of nights each year. Choose a professional sports team from a league that allows a lot of home games. Examine the quality and experience of the league and the financial health of the teams. Consider the league's capacity to fit the quality, standards, and scale required for the MPEV; **(19)** Enlist the help of a partnering sports franchise, consultant, and/or experienced operating partner to evaluate the size of the market and the types of appropriate amenities, including the number of seats, which will be both best suited and cost effective for the MPEV. Neither under-build nor over-build the capacity of the MPEV. Consider the number of seats that may be required to satisfy the market and meet the minimum requirements to attract both desired tenants and entertainment events. Consider building the MPEV to accommodate future expansion(s); **(20)** Enter into long-term lease agreements with one or more professional sports franchises with good/strong credit, and pledge proceeds from the leases to cover a portion of the MPEV's debt service. Minor league professional teams like the AHL or the NBA's development league will usually provide more capital, credit, and stability than lesser teams; **(21)** Live entertainment at MPEVs is comprised of a national network of acts, and it's a heavy, relationship-driven business. It may take a long time to convince the entertainment industry that your MPEV should be a major stop, instead of another existing stop on the entertainment circuit. Therefore, selectively choose entertainers, and be prepared to pay them more than the costs of the facility; **(22)** Conduct a separate RFP to find an operator, with both proven experience and a successful track record, that will be able to attract lots of quality entertainment events to the MPEV. Contract with the operator to manage the MPEV at an “at risk” position, since the operator, rather than the City, should assume all the risk for operating the MPEV. Otherwise, operators may be tempted to siphon funds from the MPEV, and then bill the City for the deficit in operations. If the City can’t find an operator that will manage the MPEV at an “at risk” position, then consider either (a) requiring the operator to put up a bond to cover any deficit in annual operations and/or (b) pledge an alternative source of funds to cover any future deficits in operations; **(23)** In addition to paying rent and/or an annual facility fee, the operator should also be willing to pay for all capital improvements, maintenance, and repairs during the term of the lease; **(24)** Hire a professional owner’s representative, who has developed arenas of a similar size, to negotiate leases with tenants and structure a contract with an operator to manage the entertainment venue. Keep him/her through the opening of the MPEV; **(25)** Hire an experienced, third party operator to examine and verify the operator’s proposed project pro forma for the MPEV’s operations; **(26)** Do not depend upon the revenues from the operations of the MPEV to cover the annual debt service of the MPEV; **(27)** Never believe that, “if you build the MPEV, all the ‘other’ desired development around the MPEV will come". Don’t build the MPEV as a catalyst; it is not an economic starter in and of itself. The MPEV needs complementary components to attract people and make it successful. The MPEV cannot support restaurants and retail alone; it must be part of a grander plan; **(28)** Identify all the facts, risks, and costs of the project, and go into the opportunity with your "eyes open". Remain "nimble" and always have a back-up plan. Identify the community's total cost and commitment to develop the MPEV, because unexpected future events in developing and operating the MPEV will challenge the community's will; **(29)** Calculate and consider the risk of the project in a poor economy and a "total meltdown" scenario. Confirm that the City can afford the annual debt service payment in a meltdown scenario for several years; **(30)** Very few MPEVs in mid-markets are financially self-supporting and often require an annual government subsidy for debt service, operations, maintenance, and/or repair; **(31)** Except in situations where the cost to construct the MPEV was heavily subsidized by a very large state or federal grant, **none** of the MPEVs surveyed made sufficient revenue from operations to cover both operations expenses and debt service; **(32)** Realize that it is not uncommon to offer incentives to attract live entertainers and events to the MPEV. It may annually cost a lot of money to compete with other venues that can provide entertainers with more attractive offers; **(33)** Do not pledge the City's full faith and credit to guarantee bonds to construct a MPEV, incorrectly assuming that the City's general fund will never be needed to significantly subsidize the cost of the debt service and/or a shortfall in operations; **(34)** Limit the amount of property taxes affected by the project by utilizing and pledging only sales tax rebates and/or incremental property tax revenues to support the project; **(35)** Note that the peripheral economic impact around the MPEV will not alone, on a dollar for dollar basis, generate a financial return; **(36)** In order to fund the construction of the MPEV, consider issuing certificates of obligation to pull down the rate on the bonds/debt; **(37)** Pledge a steady, dedicated, known revenue stream, other than revenue from operations, unrealized/future tax revenue from the project, and/or city's property tax revenues, to cover the long term debt service. The communities which experienced the most trouble covering the annual debt service either pledged future sales and/or property tax revenues that never realized, or inaccurately projected that revenue from operations would be sufficient to cover both operations expenses and the annual debt service; **(38)** Maintain at least a year of debt service in reserve at all times, plus a backup plan and a source of revenue to cover any deficit in the debt service and/or operations; **(39)** Use sales tax performance measures in the development agreement, especially if a dedicated source of sales tax revenue directly affected by the MPEV has been pledged to service the MPEV's debt; **(40)** Require the master developer to use only local businesses to construct the facility. Citizens will have a vested interest in building the facility, and the city will benefit from the additional sales tax and income tax, where applicable; **(41)** Do not let the developer control the parking garage and take revenue that could be used to fund the project. Control the parking, pay the master developer a fee for service, and use the parking fees to subsidize the debt service and/or operations. Rather than constructing a parking garage immediately adjacent to the MPEV, consider building it away from the MPEV with an entertainment district in between the MPEV and the parking garage; **(42)** A lot of maintenance is usually required starting in year #10. Therefore, save 10% of the operations budget each year to maintain the facility in future years; **(43)** Be patient. Developing a MPEV as part of a PPP is a long process, and sometimes several iterations are necessary to pull all the necessary elements of the project together at the same time.

Discussion

MPEVs are expensive projects that rarely generate a financial profit. Their value is not in a direct, financial return on investment, but rather on improving the quality of life in the host community. However, the community should be fully aware of the cost to develop and operate the MPEV to attract, support, and sustain the quality of life that the community wants to create. MPEVs usually require an annual debt service payment of $3.4 to $4.5 million for twenty or thirty years, and the annual operations budget for each MPEV can often cost $3.25 million dollars or more per year, excluding maintenance and major repairs. In fact, most MPEVs struggle to break even each year and often lose $200,000 to $500,000 each year on operations alone. Furthermore, based upon the results of this survey, it is **false** to believe that revenue generated through the MPEV's operations will be sufficient to cover both operations expenses and annual debt service. Therefore, owning and operating a MPEV can be a very expensive and risky investment. Communities, which have correctly assessed the inherent risks with developing MPEVs and put funding mechanisms in place to support the projects, have had very rewarding experiences. Many public entities, however, which have failed to accurately take the investment risks associated with MPEVs into consideration, have had to find uncomfortable ways to fund this unexpected financial burden on an annual basis. Every community representative surveyed said that his/her community would again develop the MPEV, if they had a chance to do all over again. However, the communities that have struggled the most reported that they wish they had conducted more due diligence on the proposed project and understood much more about the costs and inherent risks associated with developing a MPEV before committing to the project. Please refer to both Appendix B and Appendix C for additional information.

Appendix A

(1) What was the **total cost** to develop the project?

(2) How much capital did **private investors** contribute to the project?

(3) How much capital did your **community** contribute to the project?

(4) How did your community **determine** the **net economic effect/value of the proposed project** and the **amount of incentives** that the project warranted? Has that net economic effect been realized?

(5) Please describe each **of the public funding sources** (i.e. City, EDC, CVB, ISD, etc.) **and tools** (i.e. TIRZ, tax abatement, sales tax rebates, Section 380 grants, free land, etc.) that your community contributed to the project. If multiple public funding sources and/or tools were used, please describe the amount or percentage of each public funding source or tool.

(6) For other communities that have an opportunity to offer incentives for similar projects, what "**lessons learned**" could you share from your community's experience?

(7) What factors affected/motivated your community to move forward with the project?

(8) If you offered an RFP to multiple developers for the project, what criteria were the most important in your community's selection of the final developer for the project?

Appendix B

Although none of these sources were used or referenced in the research conducted for this project, suggested articles and resources for further reading include the following:

Daniels, T. L., Keller, J. W., Lapping, M. B., Daniels, K., & Segedy, J. (2007) *The small town planning handbook.* (3rd ed.). Chicago, IL: Planners Press.

International Economic Development Council. (2011) *Economic development and strategic planning.* Washington, DC: Author.

International Economic Development Council. (2011) *Real estate development and reuse.* Washington, DC: Author.

International Economic Development Council. (2014) *Seeding growth: maximizing the return on incentives.* Washington, DC: Author.

Jamison, C., & Hanks, E. K. (2015). How an innovative public-private partnership built the san marcos convention center. *Texas Town & City, CII(3), 32-35.*

The National Council for Public Private Partnerships. (2015). *7 Keys to Successful P3s*. Retrieved from http://www.ncppp.org/ppp-basics/7-keys.

The National Council for Public Private Partnerships. (2013). For the good of the people: using public-private partnerships to meet america's essential needs. *A White Paper on Partnerships.* Retrieved from http://www.ncppp.org/wp-content/uploads/2013/03/WP FortheGoodofthePeople.pdf.

The Texas State Legislature. (2011). *Chapter 2267 of the Texas local government code*. Retrieved from http://www.statutes.legis.state.tx.us/Docs/GV/htm/GV.2267.htm.

Appendix C

The following individuals and/or companies were positively mentioned or referenced during the course of the survey by one or more survey participants:

Real Estate Attorneys

Attorney Mark B. Arnold of Andrews Kurth, LLP (www.andrewskurth.com)

Attorney Paul B. Sander of Strasburger & Price, LLP (www.strasburger.com)

Consultants and Advisory

Conventions, Sports, & Leisure International (www.cslintl.com)

Crossroads Consulting Services, LLC (www.crossroads-fl.com)

FinWater Advisors, LLC (www.finwater.com)

TIP Strategies (www.tipstrategies.com)

Owner's Representatives

Bob Herrfeldt of The Ranch (www.treventscomplex.com)

John Frew of the Frew Development Group (www.frewdevelopment.com)

Jerry Reinsdorf of the Chicago Bulls (www.nba.com/bulls)

Operators

VenuWorks (www.venuworks.com)

Global Spectrum (www.global-spectrum.com)

SMG (www.smg.com)

AEG Live (www.aeglive.com)

Kroenke Sports & Entertainment, LLC (www.linkedin.com/company/kroenke-sports-enterprises)