Municipal League Foundation
Report on Issues Concerning the Seattle-King County Arena Proposal
June 6, 2012

This report is intended to advance the public discussion about the proposed new SODO stadium. However, this report does not present the final or official position of the Foundation on any issue presented. The Foundation does not make any recommendation about the proposal at this time. We invite your questions and comments, with a view to sparking additional study and discussion about the proposal.

Summary

The Municipal League review of the proposal for a new sports arena proposed in the South Downtown (SODO) neighborhood reveals the need for additional study to ensure the arena does not result in unanticipated costs to taxpayers. The City of Seattle and King County have developed a Memorandum of Understanding (MOU) with private investor Chris Hansen. The MOU is currently before the City and County Councils and must be adopted by these bodies.

The Municipal League has a 100+-year tradition of examining public proposals like the proposed sports arena. The Municipal League of King County's mission is to promote government that is open, effective and accountable, and to improve the caliber of public officials and the quality of public decisions.

The League believes the proposal has great potential to benefit the economy of our region and delights those of us who still mourn the loss of the Seattle Sonics. However, at the League, we also believe that the proposal is not risk-free and may not be self-financing as claimed by proponents.

Our review identifies questions we believe should be studied further before the MOU is adopted. How likely are sports and events fans to shift their dollars from other purchases to spending at the new arena? How much will traffic generated by the new arena affect the SODO district and, especially, the significant maritime and trade industries already located there? Can Seattle support two more first tier pro teams? Is enough being set aside to keep the new arena "first class" through 30 years of ever changing standards for sports facilities? We are not the first or the only group to ask these questions, but we hope this analysis will focus the attention of elected officials on further research that may be needed.

The Arena Proposal

Investor Chris Hansen has presented the City of Seattle and King County with a unique proposal to build a new major sports venue ("arena") in SODO, return a National Basketball Association ("NBA") team to Seattle, and perhaps acquire for the first time a National Hockey League ("NHL") team. This proposal includes several explicit mechanisms to limit financial risk to the public and places the major cost burden of land assembly, arena construction and facility operations on the private investor group(s). Hansen has also made a commitment to constructively participating in the sometimes lengthy process that precedes most major public sector decisions in Seattle.

This may well be the best deal the City and County are offered for bringing professional basketball back to Seattle. The question is, is it good enough? To help frame that question, the City and County have set forth three criteria that a proposal must satisfy:

- Existing and general fund resources are protected;
- The City and County should be significantly protected from any financial risks; and
- The partnership should result in an investment into the community and region.

This is a complicated proposal with many moving parts. Making it work well will require careful consideration of many choices and details. Conversely, there are many ways the deal could go wrong. Compounding the difficulties is the fact that this is a 30-year pact, which includes some relatively new and untested mechanisms such as a team non-relocation agreement. It is difficult to anticipate all the challenges the governments, investor group(s), and sports associations/leagues may face that far into the future and far more so to identify ways to hedge those risks.

The proposal has been characterized by elected officials and proponents as "risk free" and "self-financing," which is to say that the public portion of the costs would be paid from revenues that wouldn't exist were the new arena not built. As impressive as the proposal is, the proposal is not risk free and it is questionable (and has certainly not yet been demonstrated) that the public share of costs is really self-financing.

The Municipal League's Approach to This Review

There has already been considerable discussion and analysis of the proposal in the media, by various stakeholders and most importantly and ably by the City/County-appointed Arena Review Panel, which released its final report on April 4, 2012. In preparing this report we watched the video of the Panel's four meetings, reviewed the materials posted on their website, studied their final report, reviewed the letters from Chris Hansen to Mayor McGinn and County Executive Constantine, watched news conferences and searched the web. The Municipal League's goal is to build on the foundation of what's already been done by 1) raising new questions or drawing attention to under-appreciated questions regarding the proposal; 2) more clearly framing key questions are already on the table; and 3) broadly suggesting approaches to answering these questions at a level sufficient to decide whether this proposal merits advancing to the next stage – an MOU between Hansen and the governments.

Analysis

We've organized the issues into three categories based on their relationship to the three City/County criteria. The categories and the issues are:

1) Issues related to whether "existing general fund resources are protected"
   - Substitution
   - Externalities
   - Future general fund resources

2) Issues related to whether the City and County are "significantly protected from any financial risks"
   - Demand – whether Seattle can support two more top tier professional sports teams
   - Risk during the 30-year tenure of the partnership of arena economic obsolescence and provisions for paying for major remodels, and

3) Issues related to the extent to which the partnership "results in an investment into the community and the region"
   - How to incorporate broad City/County social justice and environmental values and how we will know that benefits outweigh potential costs of the proposal.

1) Does the proposal protect existing general fund resources?

A key and perhaps the most important issue bearing on this is substitution. Substitution is an economic term that refers to decisions by consumers to spend money on different goods and services based on cost, availability, and preference. The Arena Panel acknowledges the need for further study on the substitution effect (Arena Panel Review, 4/4/12, Section 4).

When the Sonics left Seattle, those who had been going to the games, buying meals and drinks near the Key, and buying team paraphernalia faced a decision. They could substitute the purchase of other goods and services for those Sonics-related ones that were no longer available or they could save that money for the future return of the Sonics. Perhaps they went out to dinner more often, remodeled their kitchen, bought a special sports cable package, or went to more Storm games. The point is that unless they simply saved the money, they bought the same dollar amount of other goods or services, probably near where they live. And the City and County realized some general fund revenues in the form of sales tax, B&O tax, fees and other regulatory charges from those expenditures.

Now imagine this process in reverse after a new NBA team comes to Seattle. Fans may reduce their savings rate to go to games, or they will forego some other expenditures (substitute) to make funds available for Sonics tickets. If they reduce savings, the general funds will realize new revenues from taxes on arena-related expenditures. However, if people forego other King County expenditures to attend games, the tax revenue isn't actually "new". Even if the extent of substitution is minor, the general funds will be affected because all the arena-related revenues are to be committed to arena expense and non-arena revenues will be diminished.

To what extent? At one of the Panel meetings, the Arena Review Panel staff stated that they assumed no substitution as a base case and 15% as a pessimistic scenario. These numbers seem improbably low and without support in economic studies of spending by sports fans. We believe the City and County should provide a more specific basis for these assumptions so citizens can decide for themselves whether they are credible. (This might be possible if there is data on the residences of Sonics game attendees. Dwight Dively stated that there was such data.) No substitution is plausible only if Sonics fans have been burying the money they previously spent on Sonics games and related entertainment. Moving sales tax receipts from elsewhere in Seattle and King County to SODO does not meet the Review Panel's goal to ensure the arena results in an investment in the City and region.

Another form of substitution concerns the Key Arena. In the past year the Key Arena has managed to break even by attracting more large concerts, despite its acknowledged limitations as a concert venue. Seating at the Key is substandard and it is a very inefficient venue for promoters to stage large shows because of the difficulty of getting sets and sound equipment into and out of the Key Arena by its single loading dock. If a new state -of-the-art arena opens in SODO then many of the shows that are using the Key Arena now will choose the new arena instead. And the City will get a smaller fraction of concert goers' expenditures at the new arena than it does at the Key Arena. The City as owner-operator at the Key gets the full profit on concerts there but will only get tax revenues under the proposal at the new arena. The profit would go to the investor group(s).

(Despite the severity of the Key Arena problem, we believe an argument can be made that the current proposal offers a favorable opportunity to address it. If this arena in SODO doesn't happen, it is possible that a state-of-the-art major venue will be built elsewhere in the region in the next decade or so. When it is built, the Key will lose business and if the new venue is in Bellevue or Renton, then the City of Seattle will have much less leverage to work with the investor-developers to mitigate damage at the Key Arena.)

The second "protecting general funds" issue is that of **externalities**. Externalities, like substitution, is another economic term. It refers to a negative cost or consequence not borne by the parties who create the cost. In this case the most frequently mentioned negative consequence is additional traffic congestion, which threatens to make the Port of Seattle operations less efficient by impeding freight movements from the docks to the rail yards and harm businesses in the area. The Panel avoided this issue and reasoned that the EIS and MUP processes would shed light on the extent of congestion and possible remedies.

The City and County should do more detailed study and should require traffic improvements from the arena sponsor to maintain mobility and access in the area. The City, County, and investors should include the costs to maintain mobility and access in the package, and ensure that revenues will exceed these costs. Costs of congestion are possibly of a scale that makes the entire arena project infeasible; the impact analysis needs to occur early enough in the process to bear on the go/no go decision of whether to enter into the MOU. Some have dismissed this problem by noting that the arena capacity is much smaller than that of the two stadiums in SODO now. But when traffic is already congested, the response of the system to additional stresses can mean a small change in the traffic can result in a big change in congestion.

A recently released transportation and parking study by Parametrix (funded by Chris Hansen) determined that the existing and planned transportation and parking infrastructure would accommodate the new sports arena. In the coming weeks it will be important to carefully analyze this study and its assumptions. For example, the study states that planned improvements will help accommodate the additional traffic and parking requirements. But SODO is already waiting for several planned improvements. What if some of these improvements don't happen or happen on a delayed schedule? What are the consequences?

Decision makers need to understand the potential impacts early in the process since the general funds would bear the cost of building infrastructure to address increasing demands placed on the system by the new arena and ancillary development. Additionally, the City and County need to fully consider the trade-offs if port-related and industrial businesses relocate because freight movement is further impeded.

2) Does the proposal "significantly protect the City and County from financial risks?"

The Arena Review Panel carefully considered what remedies the governments would have should the investor group(s) default or go bankrupt at some future date. Questions included what collateral the governments might have in such a situation. These are important questions but the emphasis here is somewhat different. The question we focus on is what due diligence steps can the governments take now to minimize the probability of bankruptcy or default by their private sector partners? Once a default or bankruptcy has occurred, the City and County options narrow. The best defense is to make sure this doesn't happen.

Can Seattle support two more first tier pro teams? This question was posed to Panel members and some of them offered unsatisfactory opinions that Seattle could. Hansen suggested that the governments need not worry about this question because the investor-owners weren't about to make a losing investment by bringing a $250 to $500 million franchise to an area that couldn't support it. Furthermore the leagues which must approve ownership changes and moves have an incentive to make sure a franchise will remain viable over the tenure of an agreement. But there is no shortage of league-approved ownership changes and relocations where a franchise failed to flourish because of lack of demand or local resistance to paying for expensive venue upgrades.

We believe the data show that were an NBA and an NHL franchise to move here we would be among the smaller metro areas having so many top tier teams. But a far more detailed analysis is needed to answer this question. With the growing emphasis on suites and luxury seating to make professional sport team ends meet, the question of viability includes many dimensions in addition to population. To the extent that customers are major corporations, one needs to look at corporate headquarters in the region. One would also have to consider competition from major collegiate teams.

Is enough being set aside to keep the new arena "first class" through 30 years of ever changing and seemingly increasing scale of improvements? The Key Arena went from "first class" to "we can't play there" in only 13 years -- precipitating the Sonics' departure. This wasn't because of physical obsolescence but rather, economic obsolescence. Over that time the square footage per participant in a first class NBA arena approximately doubled – in line with the necessary increase in revenue per spectator. Seattle Center simply didn't have enough room to easily accommodate the new "first class" nor the City enough money to fund it. Only 13 years after a successful $95 million remodel, estimates to bring the Key Arena up to the new first class ranged from $200 million to more than $300 million. If a region has to replace its arena every 10 to 15 years (and the replacement time has been decreasing for decades), it would suggest that the new arena's capital improvement fund would require annual deposits of $20 to $30 million in today's dollars. Are the investor group(s) prepared to provide capital improvement funding at that level? We have seen no indication of what funding level is considered necessary. If the investors are not and the local governments are not forthcoming, the usual fix is to move the franchise to a more cooperative locale. But the non-relocation agreement that is part of this proposal would prohibit this and the investors could find themselves in financial trouble, which trouble could eventually redound to the governments who would be the arena owners and financiers of last resort.

Note that as initially conceived there would be two investor groups sharing the cost of building the arena and subsequent upgrades. One group would own the NBA team and the other, the NHL team. And the arena would not be built until both team franchises had been acquired. Now in the draft MOU it appears that an NHL franchise is no longer an integral part of the deal. If this is so, the question of whether the region can support two new teams is less urgent but the question of the ability of the private investors to meet their share of the expenses much more so. With only one investor group and no local NHL team, the cost of building the arena and subsequently upgrading it will fall on a smaller group of investors who must recover these costs over a much smaller number of events in the new arena. This, of course, increases the financial risk for the investors but ultimately for their City and County partners as well.

3) Will the partnership result in an investment in the community and the region?

We conclude the answer to this is clearly yes. The new arena and one or two new franchises alone constitute a tremendous investment of resources and will create jobs during construction and subsequently in operating the facility. But is this enough? Will the City and County standards for minority hiring, apprenticeships and job training opportunities, and social justice and equity be met? Will the community's sensitivities for environmental sustainability be met? Is it fair to impose these standards on the private investors? Will the overall benefits be offset by the loss of other foregone public investments or other high-value industries and jobs? The particular difficulty here is the arena is to be designed and operated for 30 years by the investor group(s) but owned by the City and County. The City and County will have to carefully consider how to structure the design process and specify the operating standards if their larger goals and values are to be reflected in the partnership.

This analysis was prepared for the Municipal League by Bill Alves with research assistance from Jane Hadley. Bill Alves is a retired Seattle City Council central staff policy analyst whose last big assignment for the Council was the Sonics/Key Arena proposal of 2006. He previously worked in Finance at Seattle City Light and Seattle Public Utilities and was an Assistant Professor of Regional Economics and Land Use at the University of Alaska. Jane Hadley is a retired reporter with the Seattle Post-Intelligencer.