August 17, 2011

Hon. Kevin de León
Senator, 22nd District
Room 5108, State Capitol
Sacramento, California 95814

Dear Senator de León:

This letter responds to your request that we review and comment on various information that your office provided regarding the proposed Farmers Field football stadium in downtown Los Angeles. Specifically, the information we received included: (1) the memorandum of understanding (MOU) between Anschutz Entertainment Group (AEG) and the City of Los Angeles, (2) an economic analysis of the proposal prepared by Convention Sports and Leisure International for the Los Angeles City Administrative Officer, and (3) a second economic analysis of the proposal prepared by Metropolitan Research and Economics and PFK Consulting on behalf of AEG. The MOU provides the framework for a potential future agreement between the city and AEG on the financing of the football stadium and a new hall for the Los Angeles Convention Center (LACC). The two economic analyses focused on the projected financial performance of the football stadium and LACC expansion hall and the potential tax revenues from their operation.

As we discussed with your staff, we could not undertake a full review of these documents in the limited time available and thus narrowed our focus to a few key areas. Specifically, we focused on the risk to the city's General Fund from entering into the agreement outlined in the MOU. We also reviewed the methodology and assumptions used in the two economic analyses to evaluate the reasonableness of their tax revenue and job estimates. In conducting our review of these documents, we relied on the information in them as we did not have independent information on the financial operations of professional sports franchises or LACC. Accordingly, we did not attempt to directly estimate or reestimate basic data in the analyses such as construction costs, estimated attendance, projected tax revenues, or debt service.

Memorandum of Understanding

The MOU outlines a complex agreement that would result in the demolition of an existing LACC hall and construction of a new hall at LACC, two parking garages, and a special events center (football stadium). The entire project would be constructed on city land, but AEG would own and operate the football stadium and parking garages through a ground lease with the city. The MOU further requires that AEG would enter into a long-term agreement for a National Football League (NFL) franchise to play their home games at the stadium.

City's Obligation Limited to Convention Hall Lease-Revenue Bond. Under the MOU, the city's General Fund costs would be limited, as the majority of the costs for the proposed projects would be paid by AEG or with expected new revenues. The AEG would demolish the existing LACC hall and construct the parking garages and football stadium with private financing. Additionally, the new LACC hall would be jointly funded by AEG and the city. The AEG would pay a portion of the construction cost ($80 million) for the LACC replacement hall with Mello-Roos bonds secured by special taxes on two existing AEG properties (LA Live and STAPLES Center). In exchange for paying for part of the city's new convention hall, the city would grant AEG signage rights on and around LACC and extend AEG's existing ground lease for the STAPLES Center. The remaining cost of the new convention hall ($195 million) would be funded with lease-revenue bonds backed by the city's general fund. As such, the MOU limits the city's direct general fund obligations to the debt service on the lease-revenue bonds used for part of the construction of the new LACC hall.

City Would Pay Lease-Revenue Bond Debt Service With New Revenues. The MOU specifies that only new city revenues would be used to pay debt service for the lease-revenue bonds. The identified sources of repayment are:

- The annual ground-lease payment from AEG for the stadium.
- The possessory interest tax paid by AEG on the stadium and parking garage properties.
- Incremental parking tax revenue from on-site locations owned by the city or AEG.
- The city's share of construction sales tax revenue generated by the proposal.

According to the MOU and the city's analysis, these revenue sources would only just cover the debt service costs for the bonds. For example, the city estimated that in the stadium's first full year of operation identified revenues would exceed the projected debt-service costs of $11.2 million by only about $3,000. While the bonds would be used to construct a new convention hall, most of the repayment sources would depend on the success of the new stadium rather than improved operations at LACC. With the exception of the construction sales tax revenue—which is one-time revenue—the city would expect these revenues to increase annually. As noted above, we did not attempt to verify these revenue estimates. While the first three sources of repayment are fairly standard, few details were provided on how the city's share of construction sales tax revenue would be calculated and applied to debt-service payments.

AEG Responsible for Any Revenue Shortage. According to the MOU, AEG would pay for any shortfalls in the general fund revenues pledged to cover the debt service. In other words, if annual revenues from the ground lease, possessory interest tax, incremental parking tax, and construction sales tax do not meet estimates, then AEG would pay any remaining debt-service costs. Under the MOU, AEG would be required to maintain letters of credit as security for fulfilling this obligation in the event of a revenue shortfall. Assuming the contract is enforced, this would appear to eliminate any additional costs to the city beyond the identified repayment sources.

MOU Provides Other Protections to the City. In addition to AEG's responsibility to fund any revenue shortfalls, the MOU includes other elements to reduce the city's risk. For example, if the costs of the new LACC hall exceed the agreed upon budget and financing plan, then AEG would be responsible for such cost overruns unless they are caused by design changes or delays required by the city. Additionally, the MOU specifies that the city will not enter into a contract for the proposal unless AEG reaches an agreement with an NFL team to play its home games at the proposed stadium for a period of time at least equal to the final maturity of the city's lease-revenue bonds.

Some Risks Remain. Based on the above, the city appears to have done a credible job in limiting the use of public funds for the project and reducing the risk to its general fund. In fact, while most other recently constructed NFL stadiums received some public financing, the MOU specifies that AEG would fund the construction of the stadium. As with any financial transaction, however, there are potential risks:

- ***Dependent on Success of AEG.*** The city would rely heavily on AEG as a source of revenue for its debt-service obligations. The largest source of the city's repayment would be AEG's ground-lease payment, and AEG also would cover any shortfalls in the other revenues dedicated to debt service. Additionally, the Mello-Roos bond financing would be dependent on revenues from other AEG properties. As a result, most of the new convention hall's financing would rely on the financial success of AEG. If AEG struggled financially—whether from the stadium or other business operations—and was unable to meet their obligations, the city's general fund likely would be responsible for debt-service costs on the lease-revenue bonds. As the city's analysis pointed out, it is therefore important that the final agreement fully address the financial guaranty put in place by AEG and the remedies in the event of default by AEG.
- ***Length of Contract.*** The city would pay back the lease-revenue bonds over 30 years. As such, bond repayment would depend on the continued success of the stadium and LACC expansion for at least 30 years. As other cities invest in their sports and convention facilities, there would be no guarantee that the proposed facilities would remain competitive throughout the entire period. The MOU does not appear to address any long-term plan for maintaining competitiveness or funding future upgrades to the facilities.
- ***The MOU Is Not the Final Agreement.*** The MOU is only a framework for negotiations on the final contract with AEG. The actual risk to the city will depend on the protections contained in the final agreement. Any changes in estimated construction costs, interest rates, or other market conditions could require changes to the financing proposed in the MOU. Other details—such as specific definitions of city-caused design changes that would make the city liable for construction cost overruns—are also integral to determining the city's level of risk.
- ***The City Would Likely Incur Other Costs.*** While the MOU limits the city's general fund cost for the construction of the proposed facilities, it does not address other potential costs. For example, the city could incur one-time costs for infrastructure

improvements near the site and ongoing operational costs for providing services to the proposed facilities.

- ***Convention Center Dependent on Parking Revenue.*** As described in the city's analysis, parking revenue is a significant source of LACC's operating budget. The MOU would transfer some parking operations to AEG, resulting in a loss of revenue for LACC. The city expects incremental revenue from improved LACC operations and the city's parking tax to backfill LACC's losses. To the extent these revenues do not match expectations, LACC could experience budget shortfalls.

Economic Analysis

Consultants for the city and AEG completed separate economic analyses of the MOU. Each economic analysis estimated the economic activity that would result from the construction and operation of the stadium and the LACC expansion. The figure below summarizes the results of each analysis.

Summary of Economic Findings for First Year of Stadium Operations

(Dollars in Thousands)

	AEG[a]	City[b]
Events held at special events center	38	27
Overall attendance at special events center	2,094,650	1,347,100
New citywide conventions	14	5
New hotel stays	791,865	144,163
New City Revenue		
Stadium ground lease payment	$6,500	$6,500
Property and possessory interest tax	5,653	3,988
Sales tax	594	958
Transient occupancy (hotel) tax	11,570	2,181
Parking tax	1,578	775
Utility user tax	1,474	507
Business license tax	1,202	974
Totals	**$28,572**	**$15,884**
Jobs Created		
Temporary (construction)	—[c]	2,660
Permanent (operations)	—	6,320

[a] Metropolitan Research and Economics and PFK Consulting performed the analysis for AEG.
[b] Convention Sports and Leisure International performed the analysis for the city's administrative officer.
[c] The AEG analysis did not include a forecast for job creation.
AEG = Anschutz Entertainment Group.

Forecasted New Revenue for the City. Each analysis focused primarily on the economic benefits for the City of Los Angeles, although AEG's analysis included estimates of additional tax revenue for the Los Angeles County Metropolitan Transportation Authority, Los Angeles Unified School District, the county, and the state. While both analyses found that the proposal would result in significant new revenues for the city, their findings differed significantly in magnitude. These differences stemmed from the studies' different assumptions and methodologies.

Assumptions and Methodology. Estimates of the number of new events held at each facility and the spending of attendees were the focal point of both economic analyses. The expected level of spending related to attendance at these events was then used to estimate new tax revenue. Some of the assumptions that led to the difference in the city's and AEG's results were:

- ***Attendance Assumptions.*** As shown in the table, AEG assumed many more events and much greater attendance at each facility than the city's analysis. Specifically, AEG assumed the stadium would host NFL playoff games, the Pac-12 championship football game, college bowl games, the NFL Pro Bowl, and a special event like the NCAA Final Four or Super Bowl on an annual basis. The city's analysis took a more cautious approach, recognizing the low probability of annually hosting such premier events. The AEG analysis also assumed the reconfigured convention center would be much more successful at attracting new conventions and other events. In contrast, the city's consultants reported that a significant increase in convention center activity would be unlikely due to capacity constraints and continued competition from other cities. As a result of its larger attendance assumptions, AEG's analysis forecasted greater revenues from the sales tax, hotel tax, parking tax, utility user tax, and business license tax.

- ***Off-Site Development.*** The AEG analysis also included the economic effects from associated off-site developments. For example, it assumed that the construction of the stadium and improved LACC would result in the development of additional hotels and a new retail center in the area. Accordingly, AEG included tax revenues (property tax, sales tax, utility user tax, and business license tax) from these off-site developments.

- ***Use of a Multiplier.*** While the city's analysis did not make assumptions about or calculate revenue from off-site development, it did apply a multiplier to the direct spending at the stadium and convention center—that is, the city assumed the spending and earnings would circulate throughout the local economy and generate additional tax revenue. This explains why sales tax revenue in the city's analysis is greater than AEG's forecast, even though the city did not take into account off-site development. The multiplier also explains the city's large estimate for the number of jobs created, as the NFL franchise and stadium alone would likely not create 6,000 permanent jobs. Although the specific multiplier and associated calculations were not provided in the text, the city's analysis mentioned that it adjusted the multiplier for the fact that not all of the spending would circulate locally or be spent on taxable activity.

LAO Comments. Given the short time frame available for our review, we relied on the documents provided, which did not always include significant backup documentation regarding the consultants' sources, methodology, or calculations. In our high-level review, we found that the methodologies used by both the city and AEG to calculate the economic benefit, additional tax revenues, and new jobs for the proposal raise some concerns. Specifically, while both used fairly standard approaches to calculate the economic effects of new development, there are some flaws that probably overstate the economic and tax revenue benefits of the proposal—even if their assumptions regarding the number of events and other items are accurate.

Analyses Do Not Distinguish Between "New" Economic Activity and "Relocated" Economic Activity. Each analysis concluded that the stadium would attract numerous events in addition to NFL games. Many of the other assumed events already take place in the region. For example, the forecast included high school championship games, the ESPN X Games, international soccer matches, concerts, and other community events that already occur in the Los Angeles region at various venues including the Los Angeles Coliseum and the Rose Bowl. Moving these events from one place in the region to another would not create additional economic activity, but simply move it to a different venue. To a certain extent, the city could benefit if an event moved from a location outside of the city (such as the Rose Bowl in Pasadena) to the new stadium. By assuming that each event represents new economic activity, however, both studies may overstate the economic effects of the stadium.

Much of the Spending at the Stadium Would Displace Other Local Spending. Most consumers have a fixed leisure income. This means that consumers likely would substitute spending at local movie theatres, restaurants, and other entertainment venues with spending at the stadium and its associated developments. In other words, a large portion of the tax revenues generated at the stadium would be offset by lower tax revenues from other areas that would experience decreased spending. The city's analysis appears to make some adjustments for this effect, but overall the analyses did not fully address the displacement of other local spending and therefore likely overestimated the economic effects of the proposal. Once again, the city could partially benefit from this substitution effect if consumers currently spending their income on activities outside of the city would shift their spending to the proposed new facilities. Still, a large portion of the spending could simply displace spending that would otherwise occur in the city.

Most Academic Studies Find Little to No Economic Gain From Sports Stadiums. Most independent academic studies on the economic effects of sports stadiums and arenas have found that there is no significant correlation between sports facility construction and economic development. This is mostly due to the displacement of existing economic activity as described above, and also because much of the revenue associated with professional sports "leaks" outside of the local economy. (As described above, the city's analysis accounted for some of this leakage effect by reducing the multiplier effects for the direct spending at the stadium.) This does not mean that stadium construction cannot result in specific and localized development improvements. Numerous cities, including Los Angeles in connection with the construction and operation of the STAPLES Center, have seen specific downtown neighborhoods revitalized partly through new stadiums. The academic studies, however, focused on the larger citywide or regional economy and found that the development associated with new stadiums was typically offset by less investment and spending in other areas.

Regional or State Economic Benefits Would Be Minimal. While the analyses primarily focus on the economic effects to Los Angeles, the economic effects for the region or state would be minimal. The overall economic activity across the region would not necessarily increase, but instead shift to Los Angeles as described above with little net benefit to the region or state.

Competition Could Reduce Long-Term Success. The sports and convention center business is very competitive. In its forecast of revenues, the city's analysis assumed that revenues would grow at the rate of inflation. This implicitly assumes that the proposed facilities' performance would remain consistent over the next 30 years. While improvements to LACC could attract additional business in the short term, other convention centers likely would make improvements to lure business back. It may not be accurate to assume that Los Angeles could maintain its market share of convention center activity over a 30-year period without additional improvements beyond those proposed.

LAO Bottom Line

Based on the documents provided, the MOU appears to limit public costs for the stadium and new convention hall and protect the city's general fund from substantial risk. As the MOU outlines only the framework for the final deal between the city and AEG, however, the actual level of protection will depend on the strength of the guarantees in the final contract. Additionally, the MOU focuses only on the construction costs of the proposed facilities while the city could incur additional costs in improving off-site infrastructure and providing city services to the new facilities.

Compared with AEG's analysis, the city's analysis of the economic effects of the proposal made more reasonable assumptions regarding the number of new events and made some adjustments for the displacement of other local spending and the leakage of revenues outside of the local economy. Nonetheless, the methodologies used in each analysis likely overstate the potential for economic growth, new jobs, and tax revenue that could be directly attributed to the proposal. Most academic studies find little to no economic growth associated with new large sports venues, although localized improvements are possible.

If you have any questions about this analysis, please contact Mark Whitaker at (916) 319-8335.

Sincerely,

Jason Sisney
Director, State Finance