Finance Review Team Evaluation

May 31, 2017

SEATTLE PARTNERS

A. Provide a world-class civic arena (the “Arena”) to attract and present music, entertainment, and sports events, potentially including NBA and NHL events, to Seattle and the region.

Seattle Partners (SP) appears to have the experience, capability, and resources to contribute significant equity and provide a world-class civic arena. SP is a partnership between AEG and Hudson Pacific Properties. AEG is a well-recognized leader in the music, entertainment, and sports industry and has decades of experience building and operating comparable world-class arenas with municipalities in the U.S. and around the world. AEG’s experience is a major strength, and it is unrivaled in the arena and facility management industry. While an in-depth financial analysis of the company and its partners has not been conducted, given AEG’s experience, world-wide operations, and partnership with Hudson Pacific Properties, it seems to be a reasonable assumption that this group could contribute equity to the project in excess of $270 million, as currently proposed.

Prior to signing an agreement with SP, the Finance Review Team recommends a more in-depth financial review of the entity and its partners.

B. Provide for Project design and Arena operations in a manner that integrates with and enhances connections to Uptown and adjoining neighborhoods and aligns with the Urban Design Framework (“UDF”).

No Finance Review Team comments anticipated.

C. Provide for design, permitting, development, demolition (if applicable), and construction of the Arena (the “Project”) with minimal City financial participation.

SP provided the following sources and uses statement:

Sources		Uses	
Arena Revenue Bonds (City)	$250,000,000	Construction/Design	$546,250,045
Owner’s Equity	271,448,133	Capitalized Interest, Bonds	23,006,250
		Government Fees/Taxes	(47,808,162)
Total Sources	**$521,448,133**	**Total Uses**	**$521,448,133**

The City’s Design/Constructability Team is doing the financial assessment related to the appropriateness and feasibility of the construction budgets. The sources and uses assumes forgiveness or waiver of some government fees and taxes which are beyond the City’s control (e.g. state portion of sales taxes on construction). It is highly unlikely that the County or State would waive their portions of these taxes and fees, and if they do not, SP would like to explore other in-kind support or tax relief.

A weakness of SP’s financing proposal is that it requires significant City financial participation, an upfront infusion of funding from the issuance of bonds supported by incremental tax revenues. To benefit from the relatively lower cost of financing, as desired by the proposer, these bonds would need to be issued with the full faith and credit of the City. The proposed $250 million in bonds with a 30-year term would be the largest debt offering in the City's history. That said, it is well within the City's current bonding capacity and would leave the City with sufficient unused capacity for purposes beyond the City's current obligations.

The debt service is currently assumed to have backloaded payments with $11.25 million in year one with payments increasing 2.58% annually. In SP's financial model, the bonds are assumed to be two years of interest-only payments during the construction period, but SP indicated it could be flexible and pay fully-amortizing from the start. Backloaded debt, while common for private ventures, is not current practice for the City and is not considered a desirable approach. The proposal includes $23 million in capitalized interest, which is when a portion of the bond proceeds is set aside to pay bond interest until the arena begins to generate revenue. This practice is well outside of the City's traditional financing structures. It adds risk because it places more reliance on future revenue growth. SP indicated it would be open to working with the City to design an approach that would work for both parties.

Given the public financing is guaranteed by the full faith and credit of the City, rating agencies would probably note and monitor such a large bond offering from the City for an arena. However, the proposed arrangement would not be likely to cause a downgrade of the City's credit rating. From the City's perspective, to evaluate the risk associated with repayment of the bonds, it requires an analysis of the proposed revenue streams to pay the debt service. SP proposed the following (shows Year 1 projected revenue and the Annual Increase):

- City incremental tax revenue: $3.6 million/2.9%
- Per ticket facility fee: $3.9 million/2.3%
- SP rent payment: $5.0 million/2.0%

While the above revenues would be the primary source of repayment, to the extent the above sources do not cover debt payments in any given year, AEG (and/or its partners) will guaranty the debt payment. From the proposal: "For any fiscal year during the term of the Lease Agreement in which the payment of Rent and the Facility Fee and City's receipt of incremental tax revenues do not fully satisfy City's annual repayment obligations on the City Bonds, Seattle Partners will make a payment to City in the amount of such shortfall." SP clarified this further during in-person meetings and in writing that surplus proceeds would be for the benefit of the City to use at the City's discretion. However, if a surplus year follows a shortfall year, the City will first refund SP for its preceding shortfall payment from surplus proceeds. This is on a year-by-year basis, so the surplus is not cumulative and would not be applied to a future shortfall. A similar guaranty arrangement—AEG's agreement with Los Angeles for $58 million in public financing in bonds and reserves for the Staples Center—resulted in AEG fulfilling its guarantor obligations to make small additional payments in the early years.

Given the reliance on revenue streams to pay the debt service, an in-depth analysis of the viability of the projected revenue is warranted. Based on the initial review, the sustainability of selected revenue sources is a significant concern. See Section D below for more operational revenue details.

Deposit

SP proposes a $5,000,000 deposit upon execution of the Development Agreement. The multi-million-dollar deposit demonstrates the proposer's confidence in its ability to execute its development plan. This is a strength in their proposal.

D. Provide for the continuous, successful, sustainable operation of the Arena as a world-class civic venue with minimal City financial participation.

Overall, the operating proforma is optimistic and aggressive. The sponsorship and premium seating revenues, accounting for 71% of total revenues, are extremely optimistic, especially for a building without an NBA or NHL franchise. This portion of the proforma is considered a weakness as it calls into question the sustainability of the project under the proposed terms. In 2015, AECOM prepared a report, estimating arena revenues and expenses for a modernized KeyArena and a renovated arena with (a) an NBA team or (b) an NBA and NHL team. The table below provides a comparison of SP's proposal, KeyArena's current revenues, and AECOM's projected revenue estimates.

($000s)	Seattle Partners No NBA or NHL (Year 1)	KeyArena (2016)	AECOM Modernized Arena, No NBA, NHL (2020)	AECOM Upgraded Arena w/ NBA, or NBA and NHL (2020)
Naming	In sponsorship #s	0	1,177	3,000 or 5,000
Sponsorship	16,331	355	358	6,000 or 8,000
Premium Seating	22,898	1,550	992	Team controls
Total	**39,229**	**1,905**	**2,527**	**9,000 or 13,000**

Some additional proforma notes:

- Event projections, while optimistic, are achievable. The proforma for a stabilized year, among other events, assumes 24 Tier-1 concerts, 18 Tier-2 concerts, and 20 of the less-profitable family events. In 2016, KeyArena had 25 total concerts and six family shows.
- Expense projections are similar for each proposer and appear reasonable.
- Seattle Storm, Bumbershoot and the Seattle/King County Medical Clinic will be accommodated. Seattle University will not play at the arena.

City Financial Support for Operations

In addition to the upfront capital investment, the City would:

- Essentially provide use of the land and facilities rent free for the length of the agreement as the rent paid by Seattle Partners would go towards bond repayment. The agreement is for a 35-year initial term and three, 10-year extensions.
- Contribute all incremental tax revenues generated by the facility for the length of the agreement to debt service, with any incremental taxes or facility fees in excess of the debt service requirements going to the City.
- Pay for any growth in utility costs beyond inflation.
- Forego campus sponsorship revenue growth that would exceed inflation.

While the team has not yet confirmed or completed its own tax revenue analysis, if the proposer's proforma estimates are realized, over the initial term, these costs would be partially offset by $144 million in cumulative net revenues after debt service.

Sustainable Operation – Reserves

A capital reserve account is established with regular, ongoing contributions. While the proforma estimates significant net cash flow for the facility, the sustainability of the facility is dependent on the success of premium seating and sponsorship programs, calling into question its sustainability. SP commits to covering any shortfalls but sustained losses frequently motivate tenants to seek restructuring of lease terms.

E. Provide for mitigation of transportation impacts due to Project construction and Arena operations.

No Finance Review Team comments anticipated.

F. Provide Project construction and Arena operations in a manner that is equitable for workers and consistent with the City's Race and Social Justice Initiative.

No Finance Review Team comments anticipated.

G. Provide for Project design and Arena operational integration with Seattle Center, contributing positively to the vibrancy of Seattle Center.

One concern related to the operational integration with Seattle Center is SP's proposal to take over sponsorship rights for the entire Seattle Center campus, currently generating approximately $580,000 net revenue for Seattle Center and additional programming sponsorships provided to the Seattle Center Foundation. While the City is willing to consider this proposal, the primary concerns are:

- Increased commercialization of Seattle Center (e.g. potentially, commercial names for public spaces, the addition of intrusive signage, and advertising in park spaces).
- Loss of control of the image and branding of Seattle Center.
- Honoring contractual commitments to existing tenants and clients.
- Loss of sustained sponsorship revenue growth above current levels.

While low on details, one of the proposal's strengths is the attempt to integrate with Seattle Center and address the needs and interests of tenants, users, and the community. Some examples of this positive effort include:

- Current tenants of the Blue Spruce will be provided space in the new building adjacent to the arena, although the financial and operational terms of that use are unclear.
- The skateboard park is relocated within the site and a basketball court is added. Maintenance responsibilities are not addressed in the proposal.
- The future of Pottery Northwest and the Gardener's Complex are not addressed. The proposed building on their current site is not funded in the construction budget and neither revenues nor expenses are included in the proforma. Because the site is not necessary for the success of the arena, offering the proposer use of the site could be reconsidered.