



Metropolitan King County Council Budget and Fiscal Management Committee

Staff Report

Agenda item No.:	11	Date:	September 18, 2012
Briefing No.:	2012-B0135	Prepared by:	Wendy Soo Hoo
			Mark Melroy
			John Resha

SUBJECT

Update on the Arena Proposal and related agreements among King County, The City of Seattle and ArenaCo.

On September 13, 2012 the Seattle City Council's Government Performance and Finance (GPF) Committee voted to pass version 2 of Seattle Council Bill 117480. This legislation amended the arena-related agreements authorized by the King County Council on July 30, 2012 (Ordinance 17395). The full Seattle City Council is expected to vote on the legislation passed by the GPF Committee on September 24, 2012.

Today's briefing generally describes the proposal adopted by the Seattle GPF Committee and how the recent proposal differs from what the King County Council adopted in July. The briefing also identifies issues and policy implications for King County that arise as a result of the Seattle City Council's proposal.

The policy and legal analysis of the current proposal is ongoing and will be presented in upcoming meetings of the Budget and Fiscal Management Committee.

BACKGROUND

A comprehensive review of background information related to the arena proposal put forward by the King County Executive, the Mayor of Seattle and Mr. Chris Hansen in May of 2012 has been provided in previous staff reports - this material is available online and upon request.

At the September 13, 2012 meeting of the Seattle City Council's GPF Committee, Seattle City Council central staff presented a summary memorandum describing the

revised agreements. This memorandum was prepared by Dan Eder, Rebecca Herzfeld, and Ben Noble and is included as **Attachment #1** to this staff report. Highlights from that report, and from the version of the agreements authorized by the GPF Committee, are listed below. (*Items are presented here in an abbreviated format for discussion purposes - there are many associated details that can be provided upon request or to further discussion on issues of concern to Councilmembers*)

1. Additional funding is proposed in order to support a Key Arena Fund (up to \$7M) and a SODO Transportation Infrastructure Fund (\$40M).
2. Changes in Public Financing Contribution levels - under the 'NBA-only' scenario the maximum amount of public financing is increased to \$145M from \$120M.
3. Guarantees by ArenaCo to buy the facility and/or land from the governments under specified conditions at the request of the government. This mechanism, often referred to as a "put" situation, is in effect in 3 separate places in the agreements. Likewise, a "call" mechanism has been added to allow ArenaCo the option to purchase the land and facility from the government under certain conditions. A "demolition put" has also been built into the agreements.
4. A "personal guaranty" is included to cover debt-service payments under certain conditions
5. Several changes have been made to the financial structure of the agreements including: security reserves and debt service coverage changes; base rent reduction; provisions addressing capitalized debt service amounts; contributions to city-county capital account changes; changes to operating reserves; creation of an intercreditor agreement.
6. Changes have been made to the Economic Impacts Analysis report required by the King County Council.
7. Changes have been made to requirements for ArenaCo to participate in funding pedestrian-related improvements near the proposed arena.
8. The contribution by King County under an 'NBA only' scenario is increased by as much as \$16M
9. Changes have been made to King County's indemnification language.

The Seattle City Council used the agreements authorized by the King County Council as their baseline document in their negotiations with Mr. Hansen. As such the changes described above represent modifications to the version of the agreements last seen by the King County Council.

One aspect of the Seattle City Council's proposal that received considerable attention related to the project's environmental review. As reported by the Seattle Times on September 10, 2012 "The agreement ... requires a state environmental review and an assessment of alternate sites before final legal documents are signed". It is worth noting that - although the Seattle City Council added specificity to some aspects of the environmental permitting issues - the requirement for completion of a full environmental impact statement and economic analysis including alternatives analysis, as well as completion of comprehensive review under the State Environmental Policy Act (SEPA) before public funding, were among the changes implemented by the King County Council when it approved the agreements in July.

ISSUES AND IMPLICATIONS FOR KING COUNTY

Increased King County Financial contribution

Likely the most salient issue for the King County Council's consideration related to the agreement changes is the expectation of increased financial contribution from King County under an "NBA-only" arrangement. Under the current agreements King County would be required to provide an increased amount of funding for the project (beyond amounts considered in the County-adopted agreements) between \$0 and \$16M in addition to the up to \$5M contemplated in the agreements passed by the County Council in July. This money would go into the newly envisioned SODO Transportation fund. The exact amount of King County's total increased contribution is dependent upon tax revenues generated by interim play at Key Arena and at the new arena prior to the Second Installment – these figures can only be roughly projected at the current time. There appears to be a conflict in the language describing this new arrangement that could affect the government contribution amounts – *King County Council and Seattle Council staff are investigating this issue and will provide more details at the next meeting.*

SODO Transportation Fund Management

The revised agreements detail the creation of the SODO Transportation Fund and the general outlines as to how the money will be spent. The fund is intended to support projects outside of "any project-specific transportation infrastructure mitigation required through the permitting and SEPA process for the Project". Additionally, the revised agreements specify that "Further details related to the oversight and governance structure of the SODO Transportation Infrastructure Fund shall be delineated by future City ordinance" [emphasis added].

Changes to Indemnification Language

The King County Council incorporated indemnification language into the County-adopted agreements that provided broad securities and protections for the County against expenses related to Initiative 91. The City Council amended this language and legal review of the issue is ongoing.

Base Rent Reduction

The Base Rent obligation for ArenaCo has been lowered in the current version of the agreements from \$2M to \$1M. As councilmembers will recall, a difference has always existed between expected arena tax revenues projections. The City of Seattle's budget office projected lower arena tax revenues than Mr. Hansen. The Seattle budget office calculated that the Base Rent amount of \$2M would be below the amount of money from ArenaCo needed to cover the debt-obligation of the governments. The concept of "Additional Rent" was added to ensure that ArenaCo was contractually obligated to cover any difference between \$2M and the debt coverage amount. Since the base rent amount is now proposed at the lower amount of \$1M, the "additional rent" becomes that much more important. The Seattle City Council's newly-created financial protections likely help to better securitize the governments' ability to collect that "additional rent".

The Base Rent reduction (along with other modifications) do create conditions under which the governments likely have less chance of using higher-than-anticipated revenues to retire the debt early, rather those revenues would more likely go into capital accounts that would allow ArenaCo to spend the additional revenues on the facility. The Seattle City Council discussed this situation in their September 13 GPF committee meeting and acknowledged the policy decision.

Affected King County Councilmember Initiatives

Changes were made to the Economic Impact Analysis that was developed by Councilmember Ferguson. The Seattle City Council proposal also makes changes to the requirement that ArenaCo participate in funding pedestrian improvements near the arena - this requirement was developed and incorporated into the County Council version of the agreements by Budget and Fiscal Management Committee Chair McDermott.

Key Arena

A number of changes were made to the agreements that pertain to Key Arena. The most significant of which is the creation of a "Key Arena Fund". The Seattle City Council proposal captures the projected incremental tax revenues associated with an NBA team temporarily playing at Key Arena. These revenues are initially sent into a fund supporting Key Arena (up to \$7M).

SEPA

County Councilmembers may wish to incorporate language into the agreements (likely the interlocal agreement) regarding the County's role in the SEPA process

Other Provisions

- \$150K “carve-out” for Key Arena expenses
- Non-relocation requirements added for NHL team.
- Broadened Parent Guaranty
- Personal Guaranty Section added
- Put/Call/Demo Put provisions added
- Changes to required coverage ratios
- Additional third-party financial review opportunities added
- Land Use protections for Port and Industrial Areas section added
- “Arena Lease” changed to “Arena Use Agreement” throughout documents

Legal Issues

Legal review by the Council's legal counsel and the Prosecuting Attorney's Office are ongoing.

NEXT STEPS

As noted previously, the Seattle City Council is expected to act on their revised agreement at a meeting of the full Council on September 24th, 2012.

Council staff will continue analysis of the agreements, which may yet be revised by the City Council. Further development of policy analysis and options will be presented in future committee meetings.

ATTACHMENTS

1. Seattle City Council Central Staff Memo dated September 13, 2012

Attachment 1

Memo

From : Dan Eder, Rebecca Herzfeld, and Ben Noble
To: Government Performance and Finance (GPF) Committee
Date: September 13, 2012
Re: Arena Agreement Revisions

The Mayor transmitted legislation for Council's review on May 16, 2012. On July 30, 2012, the King County Council adopted both the Memorandum of Understanding (MOU) between the City, County, and ArenaCo, and the Interlocal Agreement (ILA) between the City and County, with revisions. The proposed substitute versions of these documents make significant further revisions. This memo describes the most significant changes in the documents. Please note there are additional revisions not highlighted in this memo that appear in tracked changes in the committee's materials. References in this memo are generally to the "track changes" versions of the MOU and the ILA using the King County-adopted versions as the base unless otherwise noted.

I. Significant Revisions to Memorandum of Understanding

A. Additional Funding for Public Priorities – See Attachment A

Key Arena Fund

ArenaCo remains obligated to pay for all improvements needed to host a National Basketball Association (NBA) team and a National Hockey League (NHL) team at the City's Key Arena facility during construction of the new facility. The agreement creates a new \$7 million Key Arena Fund (MOU Section 17.b) that the City will manage. Up to \$5M from the Key Arena Fund will be used for improvements at the new Arena Facility if ArenaCo and Key Arena's anchor tenant reach mutually acceptable terms for long term leases.

Consistent with the Mayor's transmitted MOU, ArenaCo remains committed to reimburse the City and County for normal permit review costs plus up to \$5 million of additional City and County "Development Costs." A new provision includes a new type of eligible Development Cost: up to \$150,000 for a study of Key Arena options for the longer-term vitality of both Key Arena and the Seattle Center (MOU Section 3.b). The Key Arena Fund ensures that at least \$2 million will be available to start implementing the preferred option.

SODO Transportation Infrastructure Fund

The agreement creates a new, dedicated source of funding for transportation projects in the SODO area and beyond (MOU Section 11). The new SODO fund gives first priority

to projects that protect the operations of the Port of Seattle and improve freight mobility; and it gives second priority to projects that improve pedestrian safety, enhance transit service and connectivity, and improve overall traffic flow in the SODO area. Funded initially with \$40 million from the Arena project, the City and County will seek to leverage additional funding from public and private partners, including the Port of Seattle and others.

The SODO fund's initial \$40 million is secured through:

- a) incremental Key Arena Taxes (after \$7 million is deposited in the Key Arena Fund);
- b) all Arena Tax Revenues for up to the first four years after the City purchases the land for the Arena; and
- c) if needed, an allocation from Installment Two of Public Financing.

In cooperation with stakeholders in the SODO area, the City commits to "undertake ... planning efforts to maximize the economic vitality of both the stadium area and the manufacturing and industrial center. These efforts will be coordinated with the transportation planning efforts and investments related to the SODO Transportation Infrastructure Fund" (Section 22.b.).

B. Changes in the Amount of Public Financing for the Arena – See Attachment B

Two Team Scenario (NBA and NHL teams are secured): Consistent with the transmitted MOU, the amount of Public Financing remains \$200 million. ArenaCo remains responsible for City and County debt service payments for the full \$200 million through Base Rent, and if needed after Arena Tax Revenues are accounted for - Additional Rent. However, in the event that any Public Financing is required to "fill" the SODO fund to \$40 million, the amount needed from Installment Two of Public Financing will be directed into the SODO fund (MOU Section 10.ii).

One Team Scenario (only an NBA team is secured): The maximum amount of Public Financing is increased to \$145 million (from \$120 million in the transmitted MOU). ArenaCo remains responsible for City and County debt service payments for up all Public Financing through Base Rent, and, if needed after Arena Tax Revenues are accounted for, Additional Rent. ArenaCo will receive no more than \$120 million. Up to \$25 million in additional Public Financing is available if required to "fill" the SODO fund to \$40 million. ArenaCo may receive direct use of an amount less than \$120 million in the event that more than \$25 million from Installment Two is required for the SODO fund (MOU Section 10.ii).

C. Enhanced Financial Protections

The new agreement increases the financial security provisions of the MOU, specifically:

Personal Guaranty: The principal owner (or successor Personal Guarantor, if approved by City and County) will provide a personal guaranty that protects the City and County in three ways:

- *Arena Site Repurchase Obligation* (Section 16.a.ii.) – Personal guaranty to buy the land back from the City and County for the price paid by the City and County, if Arena construction is not completed within five years of the date that the City and County purchased the property (called the date of the “First Installment” in the MOU).
- *Guaranty Debt Service Payments* (Section 13.g.ii.(a)) – Personal guaranty to provide funds sufficient for City and County debt service if necessary for up to a five year period.
- *Guaranty to Buy the Arena Facility and land* (Section 13.g.ii.(a)) - If the arena fails before the 30-year lease has ended and if the NBA team is sold, Personal Guarantor will purchase the Arena Facility and land for the amount of remaining outstanding and undefeased bonds, at the City and County’s sole discretion.

Security Reserves and Debt Service Coverage: The agreement better protects the public by requiring ArenaCo to double the required Security Reserve if ArenaCo finances do not perform as expected. In the event of a default by ArenaCo, the City and County will have a first lien position on the money in this account.

Operating Reserves: As an extra layer of security, ArenaCo must keep cash on hand equivalent to three months of operating expenses in an Operations and Maintenance Fund (Section 15.a).

Intercreditor Agreement: The revised MOU sets the scope for an Intercreditor Agreement to be entered into by the City and County and private lenders to ArenaCo. This agreement will determine which entities have access to which streams of revenue should ArenaCo default on its obligations, among other things (Section 13.i).

“Put”: The City and County can at their sole discretion require the ArenaCo to purchase the land and facility at the expiration of the Arena Use Agreement for \$200 million (Section 13.j).

“Call”: ArenaCo can at its sole discretion purchase the land and facility at the end of the arena use agreement for a price equal to the City and County’s initial land purchase price, as increased annually by the consumer price index, but no less than \$200 million. If this

transaction occurs, ArenaCo must construct a new arena on the site (assumes that after 30 years the arena will reach the end of its functional life) (Section 13.j).

"Demolition Put": If ArenaCo does not extend the Arena Use Agreement or exercise the "call" option, it will be responsible for paying the demolition costs on the aging arena, leaving the City with valuable, unencumbered land.

II. Other Significant Changes with Benefits to ArenaCo

Base Rent Reduction

ArenaCo remains responsible for (a) Base Rent payments, (b) remitting Arena Tax Revenues, and (c) any Additional Rent that is required to fully pay the City and County's annual debt service on the full amount of Public Financing. Base Rent is decreased to \$1 million per year from the original \$2 million per year. Assuming Arena Tax Revenues remain unchanged, the required amount of Additional Rent is therefore increased by \$1 million per year (Section 13.c).

The City Budget Office's (CBO) financial projections on the as-transmitted MOU indicated that ArenaCo would owe Additional Rent throughout the term of the Arena Use Agreement. If CBO's projections are correct, the Base Rent reductions will have no effect on the total amount of rent paid by ArenaCo (i.e., Base Rent plus Additional Rent). However, the reduction in Base Rent could benefit ArenaCo in the event that Arena Tax Revenues increase significantly faster than CBO estimates. Specifically, if Base Rent plus Arena Tax Revenues are ever sufficient to cover the City and County debt service obligations, then in any such year ArenaCo will owe only Base Rent (i.e., no Additional Rent), and the required Base Rent will be \$1 million lower per year.

Capitalized Debt Service for Up to 4 Years

New provisions increase the expected amount of capitalized debt service per year and extend the period during which most debt service is capitalized to as much as four years from the date of Installment One of Public Financing (i.e., up to four years after the Closing Date). This serves as one source of funding for the SODO Transportation Infrastructure Fund. ArenaCo remains responsible through Additional Rent for any increase in debt service costs attributable to capitalizing debt service during this period.

Excess Tax Revenues – Portion Must go to City-County Capital Account

The first \$2 million of any Excess Tax Revenues (amount of Arena Tax Revenues beyond the amount needed in combination with Base Rent to pay City and County debt service) collected annually must be deposited in the City-County Capital Account. In the sole discretion of the City and County, additional Excess Tax Revenues in excess of \$2 million annually may be (a) deposited into the City-County Capital Account (subject to limits established in Section 12.h.iv) or (b) used to retire outstanding debt (Section 13.k).

City-County Capital Account

The restriction remains that any City-County Capital Account balance must be used for “major repairs and expenditures.” However, revisions allow ArenaCo to use up to the first \$2 million deposited annually into the City-County Capital Account to fund other maintenance and repairs (Section 14.e.). In the event that ArenaCo exercises this option, it must make an equal contribution into its own Capital Account and restrict use of such contributed funding only to the same kinds of Major Capital Projects allowed for expenditures funded by the City-County Capital Account.

III. Significant Changes to the Interlocal Agreement

There are two significant revisions made in the ILA between Seattle and King County:

Funding Split By Jurisdiction

No change to the Two Team Scenario (NBA and NHL): City contributes \$120 million, King County contributes \$80 million.

The One Team Scenario (NBA only) remains unchanged except that in addition to King County’s \$5M contribution, King County will also contribute 40 percent of any allocation from Installment Two required to bring the SODO fund up to \$40 million.

Indemnification

There are technical revisions to the indemnification language that King County added to the initial version of the ILA.

IV. King County Council Changes to the MOU

The King County Council made the following significant changes to the MOU transmitted by the Mayor that were - unless noted otherwise below - incorporated in the substitute version of the MOU (section references are to King County’s MOU version):

1. Independent Review of Debt Service Coverage (Section 12.e.ii)
2. First Lien Position on City and County’s Reserve Account (Section 12.e.ii)
3. NBA Parent covenants not to encumber NBA Team proceeds beyond \$125 million (Section 12.f.ii)
4. ArenaCo and ArenaCo Parent shall be established as bankruptcy remote special purpose entities (Section 12.g)
5. Strengthened and detailed expectations that NBA Team name will be “Seattle Supersonics” (Section 20.b.)
6. Strengthened and detailed expectations that City and County will have access to information needed to review financial documents regarding the deal and ensure investors and entities can fulfill obligations as required under the agreement (Section 20.e.).

7. Requires a Community Benefits Agreement (Section 20.f.); and requires that at least 1,500 tickets be offered at NBA Team games for a price at or under \$20 per seat.
8. “In addition to any other infrastructure improvements required by permits for the Arena or resulting from the SEPA process, ArenaCo will participate in causing infrastructure associated with the Arena to be built that will provide safe and convenient pedestrian access from the Arena to the International District and Stadium light rail stations in a manner reasonably acceptable to the City and County” (Section 15.g.). **Note this item was subsequently further revised such that the new substitute amends King County’s adopted changes; see item IV.1 below.**
9. Requires that ArenaCo fund an Economic Impacts Analysis (Section 20.g.) as a new condition precedent to Public Financing (Section 21.g.). **Note this item was subsequently further revised such that the new substitute amends King County’s adopted changes; see item IV.2 below.**

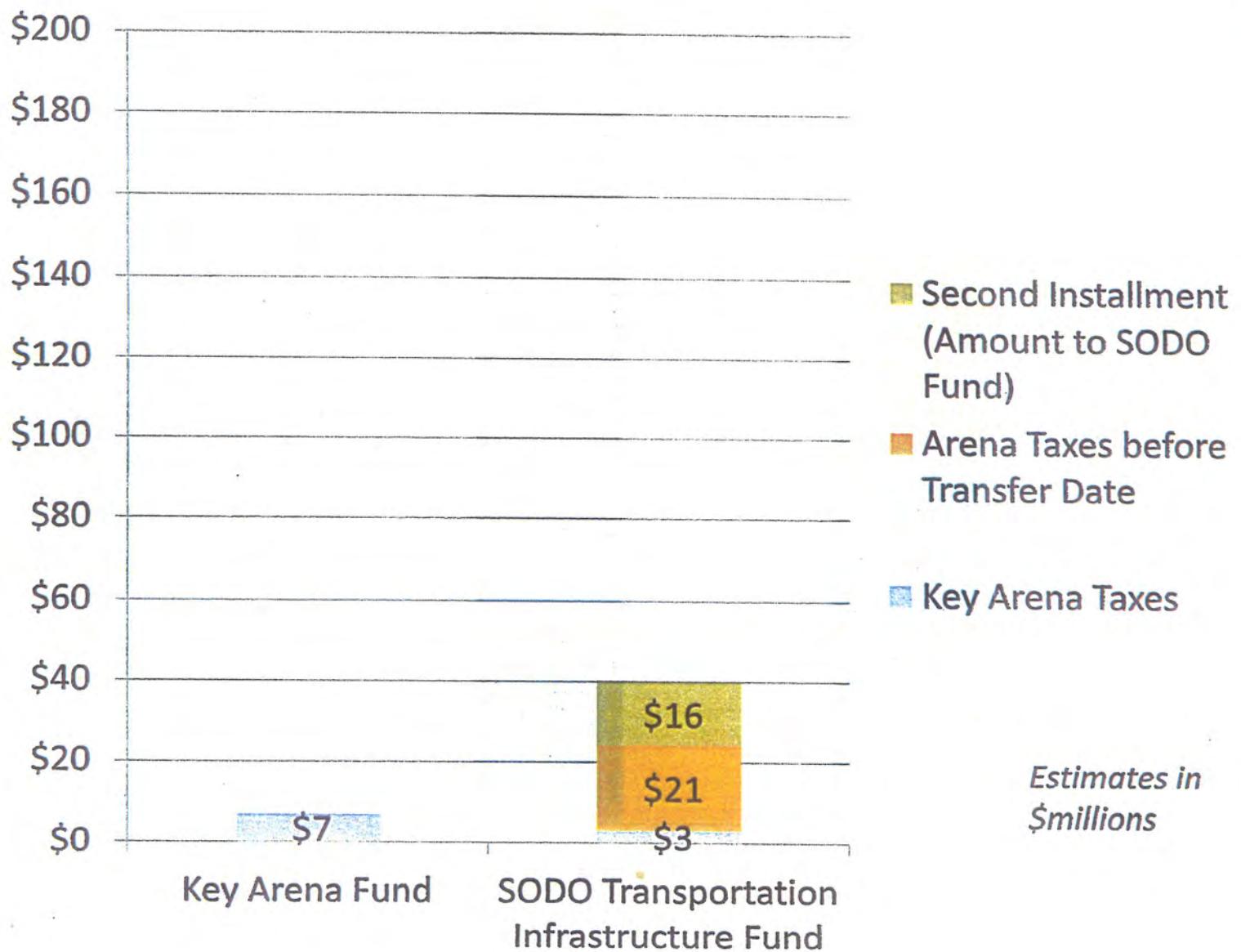
V. Further Revisions that Amend King County’s Adopted Changes:

The substitute version includes some revisions that amend King County’s adopted changes (references are to the substitute MOU version).

1. Replaces King County’s language requiring pedestrian access with similar requirements in section creating and funding the SODO Transportation Infrastructure Fund (MOU Section 11).
2. No change to requirement that ArenaCo fund an Economic Impacts Analysis (MOU Section 23.g.) as a condition precedent to Public Financing (MOU Section 24.g.). However, amount to be funded by ArenaCo reduced from \$200,000 to new amount of \$150,000 and the City and County will engage the consultant directly rather than through ArenaCo.

Attachment A: Additional Funding

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Attachment B: Public Financing

