Municipal Funding of Stadium Construction

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Abstract

Sports stadiums are expensive projects to undertake, and municipalities now bear much of the cost of financing them. Though there are serious economic costs to building these stadiums, there are quality-of-life benefits that accompany these costs. These benefits come through a sense of ownership in the local team, improved socialization opportunities, and increased civic pride. When quantified, this quality-of-life benefit equals the costs of construction, and using public financing to construct new stadiums should be pursued. However, this investment needs to be made with the realization that stadiums are a cultural investment, not an economic investment, and that the benefits associated with a new stadium only exist if a team is occupying the stadium. Therefore, only users of the stadium should pay for the costs incurred by the city, and provisions to keep the sports team in the city should be incorporated into the stadium lease.
Introduction

The practice of a municipality funding the construction of new sports stadiums has become commonplace if a city wishes to host a professional sports team. Controversy has arisen, as many feel the economic cost of funding this construction is too great to carry. However, the quality-of-life benefits gained by hosting a professional sports team, which necessitates publicly financing a stadium, equal the economic costs, and public financing of sports stadiums should be pursued, bearing in mind that stadiums are cultural attractions, and that the benefits of having a new municipally funded stadium in a city only last if there is also a sports team in the city.

Current State of Professional Sports

There are currently four major professional athletic leagues in North America; Major League Baseball (MLB), the National Basketball Association (NBA), the National Football League (NFL), and the National Hockey League (NHL). All four of these leagues are monopolies that limit the number of teams allowed to compete in them to 30 teams, with the exception of the NFL which has 32 teams. By limiting the number of teams, the leagues ensure that there are more cities that wish to host a team than teams available, creating a situation where if a city wishes to host a team, it must compete with other cities and offer a team an appealing situation to locate itself in that city.

The key part of enticing a team to either stay in the city in which it is currently located or to relocate to a new city is the construction of a modern stadium for the team. In today’s sports world, a stadium is not just a venue for a team to play its games in and charge fans to sit in bleachers, but a key part of the team’s revenue stream. Modern innovations in stadium design such as selling the rights to the name of the stadium to a corporate sponsor, offering a large variety of quality concessions and merchandise, luxury boxes which can generate large sums of money from corporate purchasers are all revenue streams a team can gain from acquiring a new stadium. Accordingly, when deciding where to locate a team, the team’s owner will choose to locate where a stadium that can offer these new streams of revenue will be built with the least cost to the ownership (Noll & Zimbalist, 1997, p. 12).

The Cost of Building a Stadium

Building new stadiums is an expensive proposition: the average cost of the 36 new venues built for “big four” teams between 1994 and 2001 was $232 million. Public financing paid for $133 million or 57 percent of the cost, on average. During the same time period, 8 major renovations costing over $60 million were completed on pre-existing stadium. On these projects, public financing covered nearly 85 percent of the cost (Rappaport & Wilkerson, 2001). In order to finance its portion of the construction, municipalities will generally use both cash from normal revenue streams and issue 30-year bonds to the additional amount needed. In order to pay back the bonds, the issuing municipality will enact some new form of tax often directly related to the use of the stadium, such as an increased tax on hotel rooms or a new tax on the sale of tickets to
sporting events themselves. Occasionally, as in the case of the construction of Miller Park, in Milwaukee, Wisconsin, a new sales tax in the areas closest to the site of the stadium will be enacted to raise the necessary funds to repay the bond (Zimmerman, 1997, p. 136-137).

Once the stadium has been built, the two parties must enter into a lease for the use of the stadium. In a publicly financed stadium, the municipality will assume the responsibility for operating the stadium and covering any losses incurred. The team will pay rent to the city for the use of the stadium (either per ticket, game or season) for a certain number of years. Additional revenues such as luxury box sales, concessions, advertising signage, parking, and naming rights will be split between the two parties on a lease-to-lease basis, however, these revenues are increasingly given to the teams as part of “sweetheart” deals to attract them to the city in question. Finally, additional clauses may be inserted giving one or both parties the right to buy out the lease or providing for penalties if the lease is violated (Noll & Zimbalist, 1997, p. 30-53).1

The net effect of these provisions is a lease that is very favorable to the team and not the city, as most of the revenue goes to the teams, and most of the operating cost goes to the city. Economic studies of the effects of stadium construction have consistently shown that stadiums do not generate significant economic development for their cost (Noll & Zimbalist, 1997, 88) and they fail to be an effective method of creating jobs (Baade & Sanderson, 1997, p. 113). To cite a specific example, in 1996 the Maryland Department of Fiscal Services conducted a study entitled *Estimated Impact of a Football Stadium at Camden Yards*, considering what economic impact constructing a new stadium for the Baltimore Ravens. It determined the total cost over the life of the stadium assumed by taxpayers for the construction of the project would be $177 million, for which $33 million of benefits would be gained. Additionally, 534 jobs would be created by the project at the cost of $331 thousand per job. In contrast, the stat Sunny Day Fund which creates new jobs in the state created 5,200 new jobs for a cost of $32.5 million dollars, of $6.25 thousand per job (Zimmerman, 1997, 123).

In addition to the direct costs incurred by the year to year operation of the stadium and servicing the debt of the bonds issued to pay for the construction, there is a significant opportunity cost associated with building stadiums, if the funds used to build a stadium are raised from normal city revenue streams or at the expense of the entire city. Improving quality-of-life through cultural attractions must be considered a lower priority in city functions than improving the city’s economic status, protecting citizens’ health or providing exceptional educational opportunities. Putting the $133 million average cost of building a new stadium into perspective in a grander scheme of costs, the state of Illinois’ All Kids program to provide healthcare to all uninsured children in Illinois cost $45 million a year (Governor Blagojevich’s All Kids, n.d.). The opportunity cost of building one average stadium with general city funds would be providing healthcare to uninsured children in Illinois (or a comparable population) three times over.

**Benefits of Stadium Construction**

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1 The large length of the citation is due to the format of the description of leasing practices in each stadium. Generalizations were made from the aggregate data.
Given the significant financial and opportunity cost for a city financing a stadium, coupled with the lack of economic benefit, what benefits does it receive from having a sports team located in its borders? The citizens of the city receive a quality-of-life benefit for having a professional sports team located in their city. Quality-of-life is defined to mean “the satisfaction, or happiness, residents derive from shared metro area attributes” (Rappaport & Wilkerson, 2001). Examples of these attributes include the relative strength or weakness of the natural attributes of the city, such as its weather (good or bad) or setting (on the ocean or on the prairie), its education system, and its cultural facilities. Stadiums are an example of cultural facilities such as museums, concert halls, and zoos; they all are non-essential services provided for the enjoyment of the citizens.

This quality-of-life benefit is reached in several ways. The first is the happiness gained by local sports fans from having a local team to cheer for and support. Having a sense of ownership in the local team’s successes and failures can provide intense enjoyment for the fan in a way that a team located outside of one’s city cannot (Rappaport & Wilkerson, 2001). The second is the extra socialization gained from attending home games at the team’s stadium. While not impossible, it is impractical to attend many sporting events outside of one’s own hometown. Attending a sporting event is a unique social experience in which a fan gets to interact with other fans in a setting not otherwise possible. This setting provides happiness and is a cherished experience for many (Santo, 2007). Finally, having a sports team in a city helps to promote a sense of civic pride in many citizens, not just sports fans. Having one or more sports teams is a mark of distinction and sets a city apart from others that do not have a team. This sense of being an elite city will help a citizen feel better about his or her community (Rappaport & Wilkerson, 2001).

Quantifying these abstract ideas that compose the quality-of-life benefit to determine if it meets the cost of financing the stadium is a difficult task. The most direct approach is to conduct a survey and to ask the citizens how much they would pay to host a team in their city. In a major study conducted during the construction of a new arena for the NHL Pittsburgh Penguins, it was determined that citizens were willing to spend $2.30 to keep the team in Pittsburgh. Given its 2.6 million metro area inhabitants, the 30 year value of keeping the Penguins would be worth $74.7 million dollars, compared to the $84 million dollar investment the city would be expected to make over that same time. The authors of the study also concluded that the benefit gained for hosting a NHL team might be low compared to other sports, as the NHL is the least prestigious of the big four leagues (Johnson, Groothuis, & Whitehead, 2001).

Another possible method of determining if the public deems the cost of financing the construction of a sports stadium worth the quality-of-life benefits it will receive is to analyze the results of direct votes on issues dealing with funding sports stadium construction. When considering the 40 referendums put to voters from 1984-2000 regarding the public financing of the construction of sports facilities, 24 passed in favor of spending public money to finance construction, a 60% success rate. In the situations studied, the public financed, on average 70% of the total stadium package. (Brown & Paul, 2002). This level of success would seem to indicate when consulted in the decision making process, citizens generally approve publicly financed stadium construction.
Conclusions and Recommendations

Considering these two methods of valuing the quality-of-life benefit against the financial cost, it is possible to conclude that benefits gained from the presence of a sports team, which requires the building of a municipally-financed stadium, nearly equal the economic cost of building the stadium. When coupled with the public’s general desire to have sports stadiums built, indicated by the high success rate of direct referenda on their construction, it can be concluded that publicly financing a sports stadium project is a valid investment by a city to increase its citizens’ quality of life, and should be pursued.

However, there are large economic costs, both in real and opportunity costs, for financing a stadium construction project. Additionally, the entire benefit a city gains is from the team being actually located in the city. There is no sense of ownership if a team is located in the city, the socialization opportunities are lost if there are no games to attend in the city, and the civic pride of having a team in the city is non-existent if the team leaves, indeed, a feeling of civic shame might be more likely if a team were to leave. If the team were to relocate from the city, the city’s investment in the stadium would become extremely costly, as it would still incur the economic costs from building the stadium, but receive no benefits from quality-of-life factors. Therefore, when putting together a public financing package to build a sports facility, cities should adopt two main policies.

First, it is necessary to realize a sports facility is a cultural attraction that increases quality-of-life only. It is not an economic investment to create economic growth or create new jobs. Therefore, spending large amounts of money from a city’s normal revenue streams or cash reserves on the construction of a sports stadium that would otherwise be spent on economic development projects, is wasteful and should be avoided. If a city intends on spending funds from these sources, it should be financed at the cost of other cultural attractions. A city should not build a stadium instead of, for example, a transportation system that would generate economic growth in a depressed area of the city. It is a far more important city function to finance policies that make significant economic improvements than to provide a quality-of-life benefit for a specific segment of the population. It would, however, be an appropriate decision to decide to finance a new stadium at the cost of building a new museum, as both investments are cultural attractions that provide a quality-of-life benefit to a specific portion of the populace. The decision then would not be an inappropriate prioritization of city functions, but a decision on which constituency to favor within a specific policy, in the same way a city must choose between pursuing a rail-based or bus-based mass transportation policy.

This policy of using only funds from normal municipal revenue streams that would normally go to cultural attractions will almost certainly require a city to issue bonds to pay for its portion of financing a stadium. This extra debt was taken on by the city to benefit a specific segment of its citizenry and that segment of the city’s population should pay the debt back. Asking non-users of the stadium, who do not see significant benefits from the stadium, is not appropriate in this case. To finance paying the bonds back, taxes and fees that target only the users of the stadium should be implemented to
make sure that this payment structure exists. This is user fee approach is common
practice today; mechanisms such as a ticket tax or sports-concession tax are used to
ensure that only those who go to the stadium pay for it. These mechanisms should be
used instead of broader-based taxes, such as a city, county, or regional sales tax to
finance the stadium.

Second, when agreeing to finance a sports facility, cities must ensure that the
sports team stays in the city until the city receives quality-of-life benefits equal to its
economic cost in building the stadium. Maintaining the team’s presence in the city is
necessary to keep the quality-of-life benefit, because as previously stated, the quality-of-
life benefit is derived from the team’s presence, not the stadium’s; the construction of the
stadium is necessary to attract the team. Keeping the team in the city can be
accomplished through carefully crafting the lease of the stadium between the city and the
team.

Perhaps the most obvious way of ensuring a team stays through the term of a
lease is to make it a clause of the lease that they must stay throughout the term or to
impose large monetary penalties if a team leaves the lease early. Such clauses would
stipulate a team must pay the costs of bond repayment for every year left in the lease that
they do not occupy they stadium. The cost of these payments would make it financially
difficult for a team to leave to another city. If the team were to leave in spite of this
disincentive, a repayment clause would cancel out the economic costs a city incurs by
building the stadium for the years it does not receive a quality-of-life benefit from having
a team in city. These clauses, however, while a possible option, are not the best choice,
for several reasons. First, penalty clauses such as these could make locating to a city in
the first place seem to be an unattractive option to a team wishing to retain mobility
option. Second, the city’s ultimate goal should be to keep the team in place in the city, so
as to continue to receive benefits from its presence, not just break even on the initial
investment, so more incentives to stay in place should be added to leases.

The best option to create an incentive structure to maintain a team’s long-term
presence in a city is to create an automatic-renewal clause. Such a clause would trigger
automatic renewals of the stadium lease beyond the initial term if the city continued to
maintain the facility at a high level and in addition to updating the facility with recent
innovations. This device has benefits and attractions for both parties to the leases and
accomplishes the goals for both the city and team. A sports team wants a modern
stadium to play in that generates money in all possible ways. If the city agrees to
continue to upgrade and maintain the stadium at or above the standards of the rest of the
league, a team will have a perpetually modern stadium, while having the option to leave
if the stadium falls below standard. A city wants to attain the quality-of-life benefits
associated with having a sports team in place at the minimum of economic cost.
Upgrading a stadium is considerably less expensive than building a new stadium
(reference the average cost of $133 million for a new stadium versus $60 million for
renovations previously cited). If these upgrades maintain the team in city, it is an
appealing option for the city. Both city and team receive considerable benefits from this
lease provision for a minimum of cost, and is an excellent way to ensure a team stays in a
city.

Another, more innovative clause, is to require the owners of a team to put it up for
sale at the appraised price to owners who would keep the team in the city before they are
allowed to break a lease without penalty. This clause is currently in the lease the Indiana Pacers signed with their municipal stadium authority, but its practicality has not been tested yet. However, it would seem to accomplish many of the same effects as the automatic-renewal clause. Team owners would likely agree to the clause, as it is a minor cost to their profit potential. If they feel as if they were not receiving a fair deal from the city in which they were located in, they would be able to either receive fair compensation for their team, or move it to another locale where they would receive the economic benefits they felt like they deserved. Cities have even more incentive for agreeing to the clause, as they would not incur additional cost for keeping the team in the city if the team was sold to private investors. If coupled with a penalty clause to cover the economic costs if the team were not sold to local investors, the city is guaranteed either a team in city, and continued quality-of-life benefits, or payments to cover the economic costs.
References


