Who Should Pay for New Pro Sports Facilities?

by Glen Hodgson and Mario Lefebvre | August 2011

Big-league teams need big-league facilities. But today's big-league facilities can easily cost $200 million or more to build. And deciding who will foot the bill inevitably leads to controversy.

The question of who should pay for new sports facilities to be used by professional teams and athletes is a frequent and hot topic of public debate. The specific issue is whether, when, and how governments should help to pay for new pro sports facilities. This issue has economic, financial, and socio-political dimensions—and there is no single right answer.

The Economic Dimension

The main purpose of a new pro sports facility is to allow a franchise and its owner(s) to be viable—that is, the facility is intended to help the private investors in the franchise make money, or at least break even. In an ideal world, pro sports franchises and their facilities would be both privately financed and profitable. Of course, things often don't work out perfectly in the real world. But a reasonable starting point for deciding whether to build any new pro sports facility would be to assess the conditions under which it could be privately financed, with investors in the facility making a profit from its construction and operation. In some cases, the economic evaluation may be positive, and the facility could then be built solely with private capital.

The Air Canada Centre (ACC) in Toronto is one of those cases. Although the financial structure was very convoluted and "creative" (including a mid-construction change in ownership in 1998 and a redesign of the facility itself), the ACC was built with private financing, thanks to a remarkably high degree of corporate sponsorship.1 As well, the ACC was built on land in downtown Toronto that was acquired from Canada Post at what was reported to be an exceptionally low price—well below its market value.2 A direct public contribution—reportedly valued at $13 million and related to infrastructure financing—was provided in the late 1990s. Ever since, the ACC's underlying economics have remained strong, since it hosts a significant number of events (up to 200 annually), each of which generates rental income and other earnings.

The Bell Centre in Montreal and Rogers Arena in Vancouver were also privately financed. The fact that these three arenas (with financially successful NHL teams as their principal tenants) were privately financed indicates that the right economic conditions for pro sports facilities to be privately financed can exist in large urban centres in Canada. (Scotiabank Place in Ottawa was also privately financed, but went through bankruptcy proceedings. It was acquired by the current owner for a fraction of the construction costs.)

However, not all pro sports facilities, and not all communities, enjoy comparable strength in terms of private financial capacity for construction, maintenance, and operation. The size of the local market may be too small; there may be only a limited number of events that could use the facility and pay rent; and/or there may be insufficient private sector appetite for risk-taking, or inadequate local and national corporate sponsorship. At that point, other questions can be posed about whether there are any economic benefits to society from making available some form of public financial support for the facility.

From a purely economic perspective, there is not a compelling case for public sector investment in pro sports facilities. But other considerations need to be examined.

Professional sports facilities can have attributes of what economists call "public goods"—that is, they provide economic benefits to society as a whole, and not just to the franchise owners, athletes, and fans. For example, a new pro sports facility and the franchise or franchises that use it might help to raise the profile of a community as a place for private investors to locate. The facility could encourage local entrepreneurs to create new ventures, or it could draw in tourists. All these things would bring ongoing economic benefits to the community. The facility can be used for other for-profit events (such as concerts), but also by amateur athletes or for other socially oriented purposes (for

example, blood donation clinics or charity fundraising events), which might increase the possible benefit to all of society. The economic benefits to the community and to society as a whole can be evaluated, as can the costs, using techniques that economists have developed over many years.

Vancouver, B.C., and Canada certainly reaped global “marquee” benefits during the 2010 winter Olympics, which could pay off in terms of increasing tourism and attracting more foreign investment, thereby offsetting at least part of the cost to taxpayers of developing the many Olympic facilities. Conversely, a public investment project that turns out badly can bring unwanted negative publicity to a community and negatively influence investor and visitor perceptions. The economic impact of the 1976 Montreal Olympics on the local economy is still a subject of debate, particularly given the recurring structural and financial problems of the Olympic Stadium (or “The Big Owe” to some of us).

In addition, positive economic benefits are likely to result from the investment, and these can be estimated. The dollars spent on labour and capital for the specific investment and its ongoing operations get re-spent in the local economy, creating multiplier effects, such as increased wages and additional jobs. But there are also bound to be significant economic costs and “leakages” from a pro sports project, including interest costs on borrowed public money, or imports used in construction and operation. A proper evaluation would need to consider whether the investment in a new professional sports facility was creating new or “incremental” activity, or simply displacing private or public investment that would have occurred in the community in any event. Governments need to consider alternative public infrastructure programs that might also generate economic and social benefits for the same funding. Public money needs to be spent wisely.

This means assessing what economists call the “opportunity costs”—a key variable in any kind of cost-benefit analysis (although challenging to assess). In the context of public money for professional sports facilities, opportunity costs mean that if a stadium or arena requires, say, $200 million in public investment, the alternative use for these public funds needs to be examined as well. If detailed economic analysis indicates that a similar investment of $200 million on other kinds of activities would yield stronger overall benefits to society, then the government should move forward with that other project, not with the stadium or arena.

In general, the economic literature indicates that publicly financed pro sports facilities do not create positive net economic benefits for the community. While positive benefits can and do exist, there are also significant economic costs associated with such projects; the public money used to construct and operate the facility is supported by the tax base and is often diverted from other uses in the local economy. From a purely economic perspective, therefore, there is not a compelling case for public sector investment in pro sports facilities. But there are other dimensions to consider.

The Financial Dimension

The financial dimension—the financial costs of private and/or public investment in sports facilities, and the revenue benefits—must be considered in detail. Many pro sports facilities utilize a blend of private and public financing, from multiple sources, in order to make the project a reality.

Let’s focus specifically on possible public sector support. There will be a direct financial cost to a government if money is borrowed to make the investment, with required regular payments of interest and the repayment of principal. If money is taken from the current budget to pay for a new sports facility, then other government priorities will not be financed and will have to be postponed or cancelled, or additional revenues will have to be raised.

The financial impact on governments can also be indirect, such as in the case of a government guarantee in whole or in part that is provided to help raise private financing. This indirect financial impact is called a “contingent liability” for the government. Appropriate government accounting practices would put a price on these contingent liabilities within a government’s books—assessing the risk of the guarantee actually being used, and the estimated cost. Complex financial techniques are now applied to most projects, including sports facilities, designed to manage the financial costs and related implications for all investors and guarantors.

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On the positive side of the financial ledger, governments derive revenues from public investment in sports facilities. Tax revenues can be generated from the facility itself, from the franchise's operations, and from the salaries of the athletes and other employees. Income taxes on player salaries (which for some athletes are in the millions) can be a particularly valuable and ongoing source of revenue. Special taxes on the salaries of visiting players have been levied in a few locations to increase the local tax revenue from pro sports. Of course, in Canada, it is the federal and provincial/territorial governments that levy income taxes, not cities—which may be a reason for opening the discussion around the role of more senior levels of government in public investment in pro sports facilities.

In recent years, the selling of naming rights for publicly financed facilities (and private ones, too) have become a very popular way of generating additional revenue from the facility, helping to cover a portion of the capital and operating costs. Of the 30 arenas that host NHL teams, only three older facilities—Joe Louis Arena in Detroit, Madison Square Garden in Manhattan, and Nassau Veterans Memorial Coliseum on Long Island—have not sold naming rights to businesses. The annual cash flow produced by the sale of naming rights varies considerably by facility and tends to be in the range of $2 million to $4 million annually. These naming rights are usually sold after the facility has been constructed, so the construction costs and risks are borne by public and private sector financiers.

We would also emphasize that direct budgetary support by governments for all or some of the construction of a new pro sports facility is not the only way to proceed. Other operating and governance structures can be created as means of building confidence that the benefits will be maximized and the costs and risks minimized. Numerous financial management options exist, including making use of private-public partnerships (or PPPs), which are increasingly being used in Canada and around the world. For example, a pro sports facility project could be designed so that the private sector assumes the risks and costs of construction and operation of the facility for a period of time, and then eventually transfers control of the property back to the government. An arm's-length management entity could be created to oversee public investment in a specific pro sports facility and to manage the performance. Or a pro sports facility could be developed and financed by the private sector, but with selective guarantees provided by the public sector for specific risks related to construction and operation. All of the options need to be considered as means of minimizing the direct and indirect financial impacts on the public sector.

The Political Dimension

The politics of possible public investment in pro sports facilities can be fascinating. Is public expenditure in a specific pro sports facility a high priority for the community? Specifically, would it improve the perceived "quality of life" for those living in the community and make people happier and more engaged citizens? Those are questions for each community to decide, through its own political process. Some communities may decide that having a pro sports franchise is so important to the community (due to its impact on its image, its culture, and/or its economy) that they will accept the financial costs and risks of building a new facility. Of course, other communities may reach a different view about the trade-off between what are generally the net economic costs of public financial support for a new facility and the perceived quality of life benefits.

Many citizens in Winnipeg today believe that the quality of life in their community has been enhanced by the return of an NHL franchise. There is an added bonus in that the arena where the Jets will play was largely financed with private money. Similarly, many citizens in Québec City believe that the quality of life in their community would be improved by the return of an NHL franchise—which is why they elected a mayor who clearly supports public investment in a new arena that would meet today's NHL standards and would help attract a team back to Québec City.

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Another question: Is it possible to reap some positive financial or economic returns from public expenditure on a new facility, giving it some attributes of an investment? Or would the construction of a new facility simply be a form of mass consumption, with the taxpayer absorbing many of the costs of construction and even ongoing operations? Again, some solid economic and financial analysis could be used to help guide the discussion through the political process.

With three levels of government in Canada (federal, provincial/territorial, and municipal), the politics of government involvement in new pro sports facilities, and the related economic impacts and finances, can be highly complex and will vary considerably among possible projects and jurisdictions. In general, there is probably a stronger economic, financial, and political case for local levels of government to invest in pro sports facilities, since most of the expected social benefits and any economic benefits would be reaped locally. More senior levels of government, or those responsible for larger jurisdictions, would have to take more fully into account issues such as fairness and a level playing field across the jurisdictions—particularly if there are requests for investment assistance from multiple cities and multiple sports.

Each government's overall fiscal capacity also needs to be considered. The recession of 2008–09 has resulted in large fiscal deficits and higher public debt loads at both the federal and provincial levels. As a result, even more than before, governments would need to demonstrate the benefit of using significant public funds to finance the construction of a pro sports facility or facilities. This is particularly true at the political level, since these facilities will be used by professional athletes earning multimillion-dollar annual salaries for, in most cases, the benefit of multimillionaire franchise owners. Moreover, given the current tight fiscal framework for most governments, cutbacks elsewhere may be required in order to make an investment in pro sports facilities.

Putting It All Together

Validating public investment in pro sports facilities is challenging, but it is not an impossible task. Governments most certainly should do their homework on the possible socio-economic benefits to the community, and come up with financial structures that make sense economically, financially, and politically—if they are to build and maintain public support for the investment. No two communities, facilities, or investment proposals are identical, so each would have to be assessed based on its own economic, financial, and political merits. The Conference Board of Canada uses its analytical tools regularly for clients, estimating the economic impacts and evaluating the financial and fiscal dimensions of a given project or proposal.

In general, local and state governments in the United States have shown a willingness to provide public support for new pro sports facilities. In Nashville, for example, the arena used by the NHL's Predators cost $144 million to build in the mid-1990s and was financed entirely by the City of Nashville through a general bond issue. Subsequently, naming rights have been sold sequentially to various corporations as a way to offset the bond payments by the city. This apparent willingness of U.S. cities and states to pay for facilities in whole or in part may reflect to a large degree the intensity of interest in multiple pro sports in the U.S. and the high degree of rivalry between and among cities. Often that support is provided by making subsidized financing available—such as through tax-free municipal bonds. But numerous other forms of concessions are also utilized, limited only by the imagination of the financiers and beneficiaries.

If governments are to reap the maximum benefits from any investment in a facility at the lowest cost possible, they need to do their homework before making commitments.

However, fiscal circumstances in the U.S. have changed. The current fiscal mess at all three levels of government will last for years to come, and will constrain the ability of governments at any level to provide future funding for facilities. (See our recent briefing Facing Up to the United States' Economic Challenges3 for a detailed discussion of the U.S. fiscal mess.)

Conclusion

In an ideal world, pro sports franchises and their playing facilities would both be privately financed and operate profitably. The facilities used by NHL teams in Montréal, Toronto, and Vancouver were constructed using private financing—which indicates that in large urban centres in Canada, the right economic conditions can exist for pro sports facilities to be privately financed. But for other facilities and in other communities, there may be constraints in terms of market size or limits to the private sector's risk-taking and financial capacity. Governments therefore face recurring requests and public pressure to provide some form of public financial support for professional sports facilities if the community is to attract or retain a pro sports team.

In general, the economic literature indicates that publicly financed pro sports facilities do not create positive net economic benefits for the community. However, those facilities could enhance the quality of life in the community and provide socio-economic benefits to society as a whole, especially if governments make use of strong economic analysis and well-designed financing and governance structures to minimize the economic and financial costs to the community. The socio-economic benefits and costs to the community and to society as a whole can be evaluated using techniques that economists have developed over many years.

Canadian governments are not immune to the pressures to finance new pro sports facilities. If they are to reap the maximum benefits from any investment in a facility at the lowest cost possible, governments need to do their homework—assessing carefully the economic, financial, and political dimensions and establishing a credible governance structure—before making commitments.